FLEXIBLE BUDGET MANAGEMENT AND "CASH-FLOW" PLAN IN NATIONAL AND INTERNATIONAL HOTEL UNITS

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Abstract. *Current/daily management of cash-flow in a hotel requires from the management providing the following important issues regarding: proper activity of the unit (sales, acquisitions, salaries); capitalization plan status (investments) and development plan; payment in installments of maturities related to various operations. In the materialization of this goal it is necessary that general manager's collaborators to participate to cash-flow management by cooperating directly with: (i) procurement officer (cost controller); the head of this Department must negotiate with the suppliers terms and conditions of payment; (ii) in this mode the unit's daily budget becomes more flexible, while becoming more responsible for preparing payment notes (city-ledger); (iii) commercial officer, that has to deal with: delays in the payment of invoices by clients; (iv) diminishing stocks to the necessary minimum (example: stocks of raw materials supply to 5 days, stocks of beverages to 10 days); (v) the opening of credit lines from banks, as well as negotiating contracts for the purchase of materials, supplies, services etc.*

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In the preparation and control of budgets of income and expenses of a hotel participates the entire management team, as well as the specialists of financial-accounting department, that by having a common vision on the business, can develop an integrated system of objectives, strategies and policies for the company, at the same time ensuring a more effective management of the allocated resources.

In such a situation, the vast majority of hotel general managers might ask themselves, for example: Why is there an increase in wage costs with 2.8%? Were salaries too high? Was there a deficiency of organizing labor?

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Thus, it appears that just the mere comparison of actual results with the programmed reference budget is not sufficient to estimate cost behavior, demanding a more thorough analysis. At the same time, the need for continuous adaptation of the actual results to the programmed budget explains the existence of the "flexible budget".

In order to achieve a flexible budget is crucial dividing costs in two main categories:

1) Fixed costs,
2) Variable costs, that changes in direct relation to the volume of receipts.

In the category of fixed costs are registered the following elements:

- wages,
- uniform
- miscellaneous decorations,
- contracts with various companies,
- rental of equipment,
- repair activities,
- fees for the financial accounting audit,
- payment of lawyers,
- charges, taxes.

Examples of variable costs of hotel:

- the cost of raw materials used in the kitchen
- the cost of drinks,
- the cost of cleaning, maintenance
- the cost of receiving products,
- tablecloths, tea towels,
- advertising,
- the franchise fees, if applicable,
- wage premiums.

The fixed costs of a hotel can vary from one season to another, during a given period of management. Most easy example relating to variation of fixed costs of a hotel unit is reflected in the salary of a chambermaid. Other fixed costs may be higher or lower, but these oscillations are due to the decision of the hotel management and not due to changes in the volume of activity.

However, in hotels there are also certain categories of expenditure that cannot be easily included in one of those two categories, i.e. fixed or variable costs, because they sometimes have both a fixed element and a

variable one. The latter are expenses that are named **semi-variable.** This category includes salaries *(chambermaids for example, employees paid depending on the volume of the activities provided),* the consumption of electricity, fuel, repairs, maintenance etc. They can be highlighted through **segregation** process**,** what allows identifying separately the fixed and the variable costs. Worth mentioning is the fact that in hotel and restaurant practice this segregation procedure is relatively difficult to implement.

Relationship cost-volume-profit (CVP analysis)

In order to analyze the Cost-volume-Profit Model – CVP is necessary to identify as accurately as possible the costs, both fixed and variable. In order to exercise effective control over expenditures it is important to know *what will be the level of the expenditure in question at a given time* and *what will be its variation in relation to sales volume modification*.

Knowing the behavior of expenditures has several utilities, among which ***breakeven analysis*****,** that represents a particular form of the CVP Model. Obviously, the *breakeven* do not represent the desired balance, but only a *reference threshold*.

The business environment does not aim to achieve a balance between receipts / income / sales and expenses, but achieving *net profit*.

Therefore, *Receipts/Revenue/Sales* required to obtain a point of balance must meet the following requirement:

SALES = COSTS

In the financial situation of a tourism company, the term of international used to satisfy this requirement is the **balance sheet** (*the reflection of the balance*).

From the point of view of costs behavior, the breakeven equation has the following expression:

Receipts = Fixed Costs + Variable Costs
Revenue – Variable Costs = MC (contribution margin)

Contribution margin equation may also be expressed as a percentage (%), for example, if the receipts are considered to be 100% and variable costs attached to them are 30%, then the contribution margin (MC) is:

- MC: 100% − 30% = 70%;
- MC (addition) is equal to fixed costs;
- MC determines the profitability threshold.

100% − 30% = 70%

The contribution margin *(commercial addition)* is equal to fixed costs and determines the threshold of profitability. Also, the commercial addition is important to be known, as it is the basis for fast calculation to determine the breakeven.

Example:

A hotel has revenues of 1,415,192 Euro for which it is estimated a percentage for variable costs up to 29.3%.

Revenue	1.415.192 Euro	100%
Variable costs	414.651 Euro	29.3%
Contribution margin	**1.000.541 Euro**	**70.7%**

If we compute the average receipt per busy room, we will be able to determine the number of rooms that will be sold out.

In our reference hotel *(fictional/imaginary),* there are 8,869 available rooms and the occupancy (GO) necessary to achieve the equilibrium point is 77.6%. In this case it appears that the ARR (Average Room Rate, meaning Income per Room / Rooms available) is 187 Euro (the data we presented were obtained from the database provided by the hotel).

The solution for obtaining the breakeven (the balance) specific for the hotel activity:

Total Receipts	1,286,998 Euro *(8,869 rooms x 77.6% GO x 187 Euro)*
Variable Costs	377,094 Euro *(29.3% from receipts)*
Contribution Margin	909,904 Euro
Fixed Costs	909,904 Euro
Breakeven	**0**

Thus, in the chosen example the *break-even is only a reference point* for planning, *the benefits being considered equal to fixed costs*.

Theoretically, the *flexible budget* is built after "recipe": *"Establish a certain / imaginary level of sales and according to this it is possible to build the budget"*.

It should be noted that hotel unit's management can build *a flexible budget for four levels of income (it is basically the realization of four flexible budgets).*

In the *master budget*, the level of employment, for example, is considered, 86.9% and further, according to four different values of employment (i.e.: 80% 83% 81% 85%) are projected other budget variants.

In other words, by adopting these assumptions / forecasts are simulated: deviations from the initial estimated employment (86.9%) and in the light of its oscillations (*lower values*) are projected appropriate budgets.

"Cash flow" and the main services on the development of the hotel

Currently*, the* ***hotel management*** *presupposes the existence of* ***specialists*** *from various* ***fields*** *such as:*

- Marketing of hotel services;
- Production of hotel services and products;
- Hospitality and restaurant management;
- Hotel management;
- Treasury management.

The latter category of specialists involved in hotel management deals with the establishment and tracking plan regarding "*cash flow*". At the same time, it should be noted that the financial function of a hotel is not limited to a mere administrative role, but also to the specialized treasury management of the economic entity in question.

In the view of the foregoing we distinguish four kinds of notions such as:

- Operational Turnover, which is carried out by the hotel and restaurant services;
- The Treasury needs/purposes other than operational ones;
- NET Treasury Unit;
- "Cash flow".

The required information is taken from the management documents (daily report, ten days report, income statement) and not from the results provided by the accounting balance sheet, because the balance sheet has a statistical nature of synthesis far too pronounced and it does not function as a dynamic tool for providing hotel treasury management.

Hotel cycle and its effects on the Treasury

In a hotel, the "cash-flow" is based on two types of cycles:

1) The short term operational cycle of exploitation,
2) The long term cycle.

The ***short term operational cycle of exploitation*** depends on the occupancy of the hotel, being a tribute to the turnover, direct expenditure management, salary costs and other costs.

Long-term cycle includes: capitalization, long-term financing cycle, as well as the variation of its own funds.

Capital cycle

A hotel management project involves, from the very beginning, the existence of a *contribution*, which is found, for the most part, in the necessary *investments*. Capital contribution may vary throughout the entire duration of a hotel operation. Generally, the capital contribution can grow only in conditions when the needs of the company suppose the realization of an acquisition or a merger. Any capital increase must be carried out in such a way as to avoid the possibility of recording certain losses. There are also situations when capital is diminished; in practice this is a rarely seen variant.

Funding cycle of hotel enterprises

Current loans repayments, as well as related interest are faced with clear deadlines to be observed strictly. The same requirements listed above appear in case of possible capital financing *(for investment)* that are scheduled and are correlated with the GOP *(Gross Operating Profit)*.

At the level of hotel chains the *funding cycle* should take into account of the effects of the *inflation rate*, as well as the *interest level variation*. These conditionings influence debt consolidation in the long run, requirement which may have an essential role in the hotel units' stability and in ensuring the best performance.

Capitalization cycle requirements

It is important to know that the cycle of capitalization needs to adapt to the chosen investment type and sometimes to its life length and amortization. As an example, below are played a couple of capitalization cycles:

- The capitalization cycle is 3 years for investments in computer science and low-value materials;
- The capitalization cycle is 5-10 years for equipment and facilities etc;
- The capitalization cycle of 20-year is for property investment, major works etc.

In hospitality, most of the time, the *capitalization ensuring is 5% of the total turnover*; thus creates prerequisites for investments, in the idea of ensuring the quality of the product offered by hotel units and can generate a greater economic value.

Management of a capitalization cycle has a decisive significance in studying hospitality activities and hence, should be given a greater attention. For example, during the first five years of operation of a new hotel, the capitalization level can vary between 2-4%, depending on the quality of the products offered to hotel guests.

"The Cash flow"

Represents the financial flow recorded by an organization and can be interpreted in various ways, as follows:

- ***"Cash flow"** generally means the GOP (Gross Operating Profit) plus the amounts not paid (for example, those for various payments) and minus the unpaid amounts relating to services, as well as the repayment of capital.*
- ***"Cash flow from exploitation**" (GOP_ exploit) means a category adapted to hospitality performances and reflects the "cash" generated by the current hotel exploitation activity.*
- ***"Cash flow gross"** (GOP_gross) takes into account losses and/or profits made from hotel's exploitation, this category excludes the effects of taxation.*
- ***"Cash flow net"** (GOP_net) considers the effects of taxation on the results of the enterprise (benefits and/or losses); it can be affected by some inflationary and/or fiscal influences; in this case you get "the adjusted cash flow".*

Configuring the required elements of the cash flow definition in a hospitality unit:

– *GOP*
– *Real estate deductions*
– *Real estate tax*
– *Location*
– *Non operational insurance*
– *Various interest at maturity*
– *Capital repayment*
– *Capitalization*
= Subtotal:

House credit	Cumulative cash-flow
Cash-flow	Taxes
Cumulative cash-flow	Cash-flow after taxes payment
Short-term investments:	Cash-flow
Interest rates for investments:	Cumulative cash-flow

"Operational cash-flow" *= GOP must ensure, in particular:*
• Payment of debts (loans + interest);
• Capitalization;
• The development plan of the hotel;
• Payment of dividends to shareholders.

The "*cash-flow*" plan has to determine the percentages awarded to: the interest, fixed rates, capital repayment, capitalization and development.

Example:

GOP	**35%**
– Real estate pre estimations	1%
– Financial payments	10%
– Capital payments	10%
– Capitalization	5%
= Cash-flow before taxes payment	**9%**

The daily management of "cash-flow" in a medium-sized or large hotel supposes on behalf of its management the assurance of the following requirements:

• Proper conduct of business (sales, purchases, salaries, etc.);
• Existence of capitalization plan (investment) and development plan;
• Staggering due dates for various economic operations.

In the day-to-day management of "cash-flow" the general manager's collaborators participate to its management through:

• Procurement Officer (cost controller) and head of this Department, who must negotiate payment terms and conditions with suppliers;

• City ledger responsible, who in collaboration with the commercial officer, must deal with solving the delays in payment of invoices by the customers;

• Initiation of mitigation actions to minimize the amount of inventory (e.g., food stocks of raw materials-5 days, stocks of beverages-10 days);

• Opening of a credit line to at least one commercial bank;

• Negotiating and preparing contracts for purchase of raw materials, supplies, food, various additional services etc.

Conclusions

The hotel unit's **budget** must always be thought on several scenarios, it has to be flexible, depending on the general context of the internal and external environment in which it operates the hospitality unit.

Taking into consideration the direct factors established by the General Meeting of Shareholders and of the Board of Directors of the establishment, who have a role in the overall budget sizing and relates mainly to: management, trade, investment, human and financial resources strategies, which aims at the achievement of the hotel's annual and quarterly strategic objectives; procurement and costs calculation policy; commercial policy of return; the policy of fixed costs and how it can respond to the general situation of the business environment.

In this way the management of daily "cash-flow" is possible and it can sustain the materialization of its role in the current management of the hotel unit.

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