

Management of financial resource and performance commerce essay



Management of financial resources is crucial in any business. According to Harrison and Enz (2005, p. 72), “ If financial resources are misused, they will not result in better human resources or superior physical assets and processes. Furthermore, strong financial resources are an even greater importance in the hospitality industry where it is a highly competitive environment and innovations are quickly imitated. If the financial resources are secured, the organization is able to invest in unique, valuable and difficult to imitate capabilities. Consequently, it can gain the competitive advantage. Intercontinental Hotels Group PLC (IHG) is the world’s largest hotel operator in respect of the number of rooms totaling 585, 094 in a 2008 report. IHG mainly operates in the UK, the US, Asia Pacific, Europe, Africa and the Middle East. Moreover, this large hotel operator consists of seven hotel brands including InterContinental, Crowne Plaza, Hotel Indigo, Holiday Inn, Holiday Inn Express, Staybridge Suites and Candlewood Suites.

Intercontinental Hotels Group operates its hotels in three different ways- as a franchisor, an owner, and an operator. Since the biggest part of the business is franchising, IHG’s focus lies on driving demands for its brands. On a global scale, the hotel operator’s distribution system includes global advertising, marketing campaigns, call centers, and local language websites (Jones, 2009). Despite having a competitive advantage with its strong brand awareness and diversified properties worldwide, IHG needs to constantly monitor its environment and identify both internal and external factors. In this manner, its national and international strategies can remain well suited to the developing environment and capabilities. While an audit of the business is necessary to analyze Intercontinental Hotels Group’s current

position, assessing the financial resources and performance carry a greater weight for decision making.

1. EXTERNAL AUDIT

Macro (PESTLE) Analysis:

Awareness of a changing environment is of central importance in developing and implementing a robust strategy. PESTLE analysis is a framework used for environmental scanning in strategic management and is comprised of political, economical, social, technological, legal, and environmental components. Political and legal factors can affect aspects of the UK hospitality industry. Tax regulations and employment laws can be altered due to the UK elections that recently took place. Hayman describes how the British Hospitality Association has asked the new coalition government to support the UK tourism industry by providing increased investment and reduced regulation (Anon., 2010). Another essential component in the external environment is the economical factor. The effects of recession have severely impacted the overall performance such as hotels' occupancy rates and revenues of the UK hotel market. Amongst these effects is the drop in international and national corporate market segment. A third component in the PESTLE analysis is the social factor. UK consumers have decreased their number of trips, number of nights spent in accommodation, and their overall expenditure. Another element in the macro-scanning is the technological factor. The rise of the internet has allowed major hotel chains to invest in websites and direct booking systems allowing consumers to book, view, and review hotels. Finally, the environmental factor is also of importance when

analyzing the environment. Corporate Social Responsibility has slowly become integrated in many organizations' business objectives. For a hotel to be socially responsible, it must follow through many policies such as abiding by the Energy Consumption laws and engaging with the local community.

Micro (Porter's 5 Forces) Analysis

The factors in the macro-environment analysis can be used to determine how the firm's industry environment (micro audit) is affected. Porter's five forces of competition framework can be used to analyze the intensity of competition and the level of profitability (Grant, 2005). These five forces include competition from substitutes, entrants, power of suppliers, power of buyers, and established rivals. The threat of substitutes for Intercontinental Hotels Group is high risk. During the recession, many customers were staying at budget hotels, which became increasingly popular amongst the leisure and corporate markets. Since the barriers to entry into the hotel industry are high, the threat of entry involved is low. The barriers included are high capital requirements or entry costs, high fixed costs, no economies of scale, and resistance from the existing market. The power of suppliers is considered medium-risk for IHG. Since furniture and fittings must be of a certain standard relevant to a hotel, they are purchased in bulk from specialist contract suppliers. On the other hand, there are no switching costs for food manufacturers and processors. Another element of the five forces is the power of buyer, which is high in the case of Intercontinental Hotels Group. The buyers are sensitive to the prices charged by the hotels in the industry. Moreover, they can easily compare not only prices but also quality and ratings via Internet using various websites. Finally, the rivalry amongst

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established competitors is of high risk. The major competitors of IHG are Hilton Hotels Corporation, Starwood Hotels and Resorts Worldwide, Hyatt Corporation, and Accor. These large hotel chains offer similar products and services, which means customers are willing to substitute.

2. BUSINESS STRATEGY

In order for an organization to compete within a particular industry, it must gain a competitive advantage over its competitors by establishing a business strategy (Grant, 2005). The main objective of a business strategy is to link an organization's internal capabilities and the external environment. IHG not only continuously monitors the environment, but also ensures that the strategy remains aligned with external factors. The core focus of Intercontinental Hotels Group is to create Great Hotels Guests Love. In 2009, despite economic hardships, IHG analyzed its operations and capabilities to focus on how to deliver Great Hotels Guests Love. This major hotel chain's strategy concentrates on two key aspects: where it chooses to compete and how it will win in the competing market. There are five key priorities in support of IHG's overall strategy. Some of these priorities include financial returns, its people, responsible business, and guest experience. The progress of these priorities is measured to ensure the achievement of Great Hotels Guests Love. Intercontinental Hotels Group's strategy is also pertinent to regional objectives and priorities.

3. INTERNAL AUDIT

3. 1 Human Resources:

In order for a strategy to be carried out, human resource is required.

According to Kaplan and Norton, human capital is the availability of skills, talent, and know-how required to support the organization's strategy (2004).

Employees are not only critical to achieving sustainable competitive advantage, but also integral in an organization's business plans. One of IHG's key strategic priorities is to use its people to create a more efficient organization with strong core capabilities. Intercontinental Hotel Group's focus lies in developing skills to support its key goals for responsible business, guest experience and financial returns by managing employee engagement. Approximately 335, 000 people are employed globally across IHG's brands including franchised and managed hotels. The business has been balancing cost reduction and restructuring programs while managing engagement for the people and guests during 2009. To achieve Great Hotels Guests Love this organization has developed a clear articulation of its values and the behaviors expected from all employees, as well as creating the right environment for employees so that they can deliver the core purpose

3. 2 Mechanical Resources:

Another type of organizational resource is non-human assets such as technology and reputation. IHG's central reservation system technology includes the operations of the HolidexPlus reservation system. This system electronically receives reservation requests entered on terminals located at most of its reservation centers, as well as from global distribution systems operated by a number of major corporations and travel agents. There are currently ten global reservation offices available to take hotel bookings from guests 24 hours a day in 26 different languages. IHG generates room sales <https://assignbuster.com/management-of-financial-resource-and-performance-commerce-essay/>

globally through their branded websites. Kaplan and Norton state that an excellent reputation for performance along social dimensions not only attracts high quality employees, but also enhances the image with customers and socially conscious investors (2004). IHG believes that corporate responsibility (CR) is integral to the way it conducts business and also at the core of its strategy. Moreover, it assists in building competitive advantage. Intercontinental Hotel Group's CR strategy is focused in the environment and its communities in order to drive increased value for IHG, owners, employees, and guests.

3. 3 Financial Resources:

While human and mechanical resources are equally important, the financial component of the strategy is just as crucial in a highly competitive industry such as the hospitality one. The balancing act of both growth and productivity dimensions is the organizing framework for an organization's strategy map. According to Harrison and Enz, "strong cash flow, low levels of debt, a strong credit rating, access to low-interest capital, and a reputation for creditworthiness are powerful strengths that can serve as a source of strategic flexibility, which means that firms can be more responsive to new opportunities and new threats" (2005).

3. 3. 1 Analysis of Key Ratios

Companies will often track trends of key ratios over several years to compare their numbers against industry averages from a major competitor to assess comparative financial strength (Harrison and Enz, 2005). The

following are some key ratios using IHG financial information from its annual report:

a. Liquidity ratios help an organization determine its ability to pay short-term obligations such as debts and payables (Bertoneeche and Knight, 2001).

i) An example of this is Current Ratio, which can be formulated as follows:

Current Ratio= Current Assets/ Current Liabilities

2008:

Current Assets= \$544m

Current Liabilities= \$1141m

Current Ratio= 0. 47

2009:

Current Assets= \$419m

Current Liabilities= \$1053m

Current Ratio= 0. 40

Because the Current Ratio is below 1 for both years, it suggests that IHG is unable to pay off its short-term obligations if they were due at that point. The decrease of current assets is probably due to the recession period. Although this implies that the organization is not in good financial health, it does not necessarily mean that it will go bankrupt.

ii) Another example of a liquidity ratio is the quick ratio also known as the acid test and can be figured as shown below:

$$\text{Quick Ratio} = (\text{Current Assets} - \text{Inventories}) / (\text{Current Liabilities})$$

2008:

Current Assets= \$544m

Inventories= \$4m

Current Liabilities= \$1141m

Quick Ratio= 0. 47

2009:

Current Assets= \$419m

Inventories-\$4m

Current Liabilities= \$1053m

Quick Ratio= 0. 39

The difference between current ratio and quick ratio is inventories. Inventory is excluded in quick ratio since some companies have difficulty turning their inventory into cash. In the case of IHG, the quick ratios for both 2008 and 2009 are similar to the current ratios. Since the hotel industry is mostly service oriented, there are not much inventories to turn into cash.

b. Profitability ratios are another key dimension to an organization's firm health. According to Harrison and Enz (2005, p. 72), " They are a common measure of overall financial success".

i) One type of profitability ratios is net profit margin ratio can be calculated as follows:

$$\text{Net Profit Margin} = (\text{Net Profit} / \text{Revenues}) * 100$$

2008:

$$\text{Net Profit} = \$262\text{m}$$

$$\text{Revenues} = \$ 1897\text{m}$$

$$\text{Net Profit Margin} = 0.14 \text{ or } 13.81\%$$

2009:

$$\text{Net Profit} = \$214\text{m}$$

$$\text{Revenues} = \$1538\text{m}$$

$$\text{Net Profit Margin} = 0.14 \text{ or } 13.91\%$$

For every \$1 generated in revenue, IHG made a profit of 13.81% in 2008 and 13.91% in 2009. Even though the net profit and revenues for 2008 are higher than that of 2009, there was a slight increase in the net profit margin.

ii) Another profitability ratio is gross profit margin which can be determined as follows:

$$\text{Gross Profit Margin} = (\text{Gross Profit} / \text{Revenues}) * 100\%$$

2008:

Gross Profit= \$1045m

Revenues= \$1897m

Gross Profit Margin= 0. 55 or 55. 08%

2009:

Gross Profit= \$678m

Revenues= \$1538m

Gross Profit Margin= 0. 44 or 44. 08%

Gross profit margin discloses the profit an organization makes on its cost of sales. IHG's gross profit margin decreased in 2009 due to lower revenues and higher cost of sales compared to 2008. This simply shows that the efficiency of operations and product pricing subsided.

iii) Return on capital employed ratio compares the profit made by an organization with the amount of money invested. The formula is as follows:

$ROCE = \text{Net Profit} / \text{Capital Employed}$

$\text{Capital Employed} = \text{Shareholders' Funds} + \text{Long Term Liabilities}$

2008:

Net Profit= \$262m

Capital Employed= \$1972m+\$1= \$1973m

ROCE= 0. 13 or 13. 28%

2009:

Net Profit= \$214m

Capital Employed= \$1684m+\$156m= \$1840m

ROCE= 0. 11 or 11. 63%

According to the authors in Business Studies, the higher the ratio, the better indication of performance it is in terms of profit returned for the capital invested (Hall, Jones, and Raffo, 2004). Over the past two years, the ROCE has decreased from 13. 28 per cent to 11. 63 per cent. This means that less profit was made to cover the capital employed.

c. A third key dimension to assessing an organization's financial standing is efficiency ratio, which evaluates how effectively capital is employed within the firm (Bertoneche & Knight, 2001).

i) Asset turnover ratio reflects how assets are being effectively used to generate revenues. The formula is the following:

Asset Turnover Ratio= Revenues/ Total Assets

2008:

Revenues= \$1897m

Total Assets= \$3118m

Asset Turnover Ratio= 0. 61

2009:

Revenues= \$1538m

Total Assets= \$2893m

Asset Turnover Ratio= 0. 54

From this ratio analysis, IHG had a decrease in its asset turnover from 2008 to 2009. For every \$1 of assets it owned, IHG generated \$0. 61 of sales in 2008 and \$0. 54 in 2009. Since the ratios for both years are relatively low compared to other industries, the organization might not be utilizing its assets to a full potential. However, the profit margin ratio is higher compared to another sector of the hotel industry such as budget hotels.

d. Gearing ratios illustrate the long term financial position of an organization. They can assess whether or not a business is burdened by its loans (Hall, Jones, and Raffo, 2004). The formula for gearing is as follows:

Gearing= Fixed Cost Capital/ Long Term Capital

Long Term Capital= Shareholders' Funds + Long Term loans

2008:

Fixed Cost Capital= \$1972m

Long Term Capital= \$1m + \$1972m= \$1973m

Gearing= 0. 99 or 99. 95%

2009:

Fixed Cost Capital= \$1684m

Long Term Capital= \$156m + \$1684m= \$1840m

Gearing= 0. 92 or 91. 52%

Since the ratios for both years are higher than 50 per cent, IHG is considered a high geared company. This simply signifies that a much higher proportion of total capital is borrowed. Even though the gearing ratio decreased from 2008 to 2009, IHG is still considered as risky by creditors.

After analyzing the key ratios previously formulated and comparing between 2008 and 2009, one can conclude that Intercontinental Hotel Group is not financially fit. Both liquidity ratios, current and quick, decreased from 2008 and 2009 signifying that assets cannot easily be turned into cash. Moreover, the decrease of profitability ratios including gross profit margin and ROCE indicate weakness of the business. The net profit margin, however, did slightly increase from 2008 to 2009. Furthermore, IHG'S poor asset turnover ratio shows that the company is not using its assets effectively. Lastly, the organization's high gearing nature also contributes to the fact that IHG is reliant on borrowed business. Overall, it needs to make changes to improve its financial health.

4. RECOMMENDATIONS/ CONCLUSION

The utilization of an organization's resources must not only be effective, but also efficient (Pettinger, 1997). While the strengths of IHG management for both financial and non-financial resources can be enhanced, the weaknesses must not be overlooked. In order for IHG to carry out their strategic objective of creating an efficient organization, its human resource management must be committed to several practices such as selective hiring, focus on training and development, communication and information sharing, good level of compensation, and team working (Porter, Smith, & Fagg, 2006). In this manner, IHG will be able to achieve positive human resource outcomes, which can lead to quality and productivity. This in turn can heighten the organizational performance in terms of financial outcomes. Furthermore, IHG management can take general action to increase the stream of cash flows and drive value. Increasing business with current customers, expanding global presence, reducing expenses and pursuing complementary alliances can all promote growth. According to DeFranco and Lattin(2007, p. 119), "Rather than focus on expansion in a single city, some companies elect to expand to new markets. The benefit of this type of growth is that it spreads the risk of expansion over several markets". For example, concierge services can incorporate the usage of iPad to visually assist the guests' common questions such as directions. Another example is diversifying related products such as vacation ownership and corporate housing. By doing this, Intercontinental Hotel Group will be able to enhance its product image. Margins can be improved if IHG focuses on restructuring, efficiency, productivity, and cost control. Moreover, increasing inventory turns and getting best conditions from suppliers can aid in lowering the company's working capital. The organization can also optimize asset utilization by either

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lowering capital expenditures or improving turnover ratios (Bertoneche & Knight, 2001). An example of a capital expenditure is restoring a property or adapting it to a new or different use. In the case of IHG, this can involve renovating or refurbishing one of its hotels. By lowering capital expenditures, the balance sheet can be affected positively.

In conclusion, IHG has managed to successfully remain as one of the top hotel chains worldwide, it still needs to constantly be monitoring the external and internal environment to be able to compete in the hospitality industry. As more and more competitors are arising, IHG need to continuously revise and review its strategic objectives, which include human resources, mechanical resources, and financial resources. By evaluating financial ratios, IHG can monitor the performance of its operations and evaluate its efforts to meet a variety of goals. By tracking a selected set of ratios on a regular basis, the organization is able to maintain a fairly accurate perception of the effectiveness and efficiency of its operations (Andrew, Damitio & Schmidgallm 2007). Even though the hospitality industry is dynamic and exciting, it poses many challenges such as low profitability, reliance on discretionary income, capital intensive, fluctuating sales volume and labor intensive. IHG has to ensure that it is able to overcome these challenges so that it can grow and increase its value.

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