Governance Essentials

A Data-Driven Perspective on Food & Beverage in Private Clubs

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Dear Fellow Club Leader,

“Driven to Learn” is a Club Benchmarking core value. That passion for data science, knowledge and discovery is in our DNA, and since the company was founded in 2009, our efforts have been fueled by industry professionals graciously sharing their own insight and experience.

The analysis and conclusions presented in these pages would not have been possible without the generous support and cooperation of the board and management team at Monterey Peninsula Country Club (MPCC) in Pebble Beach, CA. We are especially grateful to have MPCC General Manager JJ West as our co-author for this whitepaper which is aimed at putting to rest the industry’s most dangerous and pervasive issue – misconceptions related to F&B profit or loss in the private club industry.

The topic of F&B in clubs is shrouded in misconception due to lack of context surrounding the significance of F&B financial outcomes. As a result, clubs can and do become “stuck” in what we have dubbed the F&B Trap – rigid adherence to the belief that a club should make a profit in F&B (or “lose less money”) and that a club is healthier if it makes a profit in F&B than if it shows a deficit in F&B. Club Benchmarking data shows the exact opposite to be true and we will delineate the facts that demonstrate it in this whitepaper.

The Monterey Peninsula story is our case in point. By sharing the data, analysis and process that drove key leadership decisions, JJ and his team helped us more clearly understand a key financial concept; the CHOICE of covering operating costs from margin on non-dues revenue based on member usage with high use members covering a higher burden of operating the club, versus covering costs through membership dues revenue which spreads the burden of operating the club more equally among all members. Club Benchmarking has already discovered new metrics because of the learning we enjoyed with JJ and his team, and we will continue to evolve and disseminate that knowledge for the benefit of the club industry.

With Deep Gratitude,

Raymond P. Cronin

Ray Cronin and the Club Benchmarking Team

Introduction

Over the past 11 years, through the process of presenting a data-driven view of the financial and business model to the Boards/Committees/Staff/Members of more than 500 clubs across North America, a clear pattern has emerged. In addition to first-hand experience working with so many clubs, the author of this white paper sat on the Board of his own club for 10 years and witnessed many incoming Board members take their seats for the first time.

All this experience has led to a critical observation: The most relentless and dangerous issue facing the club industry is what Club Benchmarking refers to as the "F&B Trap."

The F&B Trap

The Club Benchmarking mission is to elevate fact over opinion in the boardrooms of clubs across the industry. The club industry is a fragmented, cottage industry. Until Club Benchmarking was founded, as is typical in a cottage industry, the industry did not have the data and associated analysis to understand, in a fact-based manner, its own business model. While there were many euphemisms such as "clubs are in the dues business," or "F&B is an amenity, not a profit center," the data did not exist to quantify exactly what those statements meant or how they should be embraced in terms of governance in the club boardroom.

Since 2009, Club Benchmarking has been collecting, standardizing, and analyzing year-end financial results from nearly 1,000 clubs, and recently began gathering certain membership, cost of belonging, initiation fee and finance data on a monthly basis. Our ongoing analysis has revealed a fact-based view of the drivers of financial success over time. The data shows ***exactly*** how the financial outcomes in food and beverage relate to and impact a club's overall financial success (or lack thereof). The fact-based insight runs completely counter to the intuitive dialogue on F&B in nearly every club boardroom and Grille room.

A cottage industry, as defined by Merriam-Webster, is a "small and often informally organized industry." In the club boardroom, "informally organized" helps explain the opinion-based views of F&B. Prior to a fact-based view, and the logically associated best practices that flow from those facts, a widely held view was that the financial outcome in F&B was an issue of paramount importance. Unfortunately, even with the fact-based view of F&B that exists now, there is still widespread misinterpretation of F&B financial outcomes and how they relate to a club's financial success over time. It isn't a stretch to say that the F&B Trap, defined as a nearly singular focus on the financial outcome in F&B, is an obsession in club boardrooms across the industry.

This Club Benchmarking white paper is an attempt to present the facts as they relate to F&B financial outcomes in an effort to free club staff, board, finance and house committee members from the problematic paradigm that a "loss" in F&B is a "bad outcome" that occurs due to mismanagement or lack of efficiency.

That paradigm results in thousands of hours of wasted effort across the industry year-in and year-out as new board members enter the boardroom. Time spent running reports, analyzing labor and cost of goods trends, etc. detracts from focus on the financial outcomes that do matter such as the club's value proposition and member experience, net worth over time and the state of the physical assets as a result of capital income and investment. From the author's perspective, the F&B Trap is a canard that deters boards and committees from focusing on healthy club governance.

Perspective

While this white paper may not convince every reader of the fact-based view of F&B's financial outcome, hopefully it convinces enough people at each club to use the information to avoid or remove themselves and their club from the F&B Trap – likely over the protest of the folks who are not convinced (the F&B Hawks).

We refer to the issue as a trap because volunteer board or committee members can become "stuck" – taking a narrow view of all things finance through the lens of the F&B deficit. When enough people in a club's governance system become stuck, the club becomes stuck. We have found boards and committees do well, as the old saying goes, at "getting what they wish for." The 20 percent of the industry that makes a profit in F&B does so because that is their primary focus. Unfortunately, in terms of overall financial health, those clubs making a profit in F&B are weakest in the industry. The logic presented in this paper is informed by an economic concept called "thinking at the margin." The Library of Economics and Liberty website defines "thinking at the margin" as letting the past go and thinking forward (reflecting the concept of sunk costs). Another definition, according to Wikipedia, is to "understand constraints at the border of an idea." In this white paper, the term is meant to consider the main factors influencing an outcome. For instance, in the context of F&B financial outcomes in clubs, given 80 percent of clubs "lose" money in F&B, is it rational to conclude that is a "bad" thing and the result of inefficiency? A broader perspective must consider the more logical possibility: There must be a reason that F&B "loss" is so pervasive, and given that pervasiveness, it is unlikely a result of inefficiency. Is every club in that 80 percent inefficient? Are they all embracing a "bad" business practice?

The common question heard in boardrooms and finance committee meetings in pondering F&B finances in a club is "why can't we make money like a restaurant?" There are a couple of points of logic behind this question. Which restaurant do we wish to emulate in making money? The 60 percent that fail within three years (according to a study by Cornell University), the McDonalds down the street or the high-end, expensive, chef-owned restaurant downtown? They all have different business and financial models. Would a restauranteur open a restaurant that can only serve a specific five to seven hundred people? Would a restauranteur offer a breakfast service trafficked by a handful of customers? Would a restauranteur consistently allow patrons to order “off menu” as a matter of practice?

In the end, a private club’s F&B operation is not a restaurant. It is different. This white paper will explain the financial differences. Comparing the financial outcome of an F&B operation in a club to a for-profit restaurant is analogous to comparing that club’s golf course to the municipal or public course across town. They may both have eighteen holes, but the similarities end there.

This paper is an exercise in fact and logic with the objective of presenting a case that changes the reader’s perspective. The case being presented centers on the following series of questions, each of which will be addressed using data:

- What are the financial results in F&B across the industry?
- What causes the financial results?
- How do those results compare to other department results?
- Why does the focus land on F&B instead of other departments?
- What is the fact-based view of the financial outcome in F&B?

If the case presented sways enough readers in each club stuck in the F&B trap to shift their focus, the final point addressed in the white paper is this:

- What topic should replace the discussion concerning F&B financial results?

The Financial Results in F&B

Two views of the financial results in F&B are presented in Charts 1 and 2.

Chart 1 – Financial Results in Food and Beverage

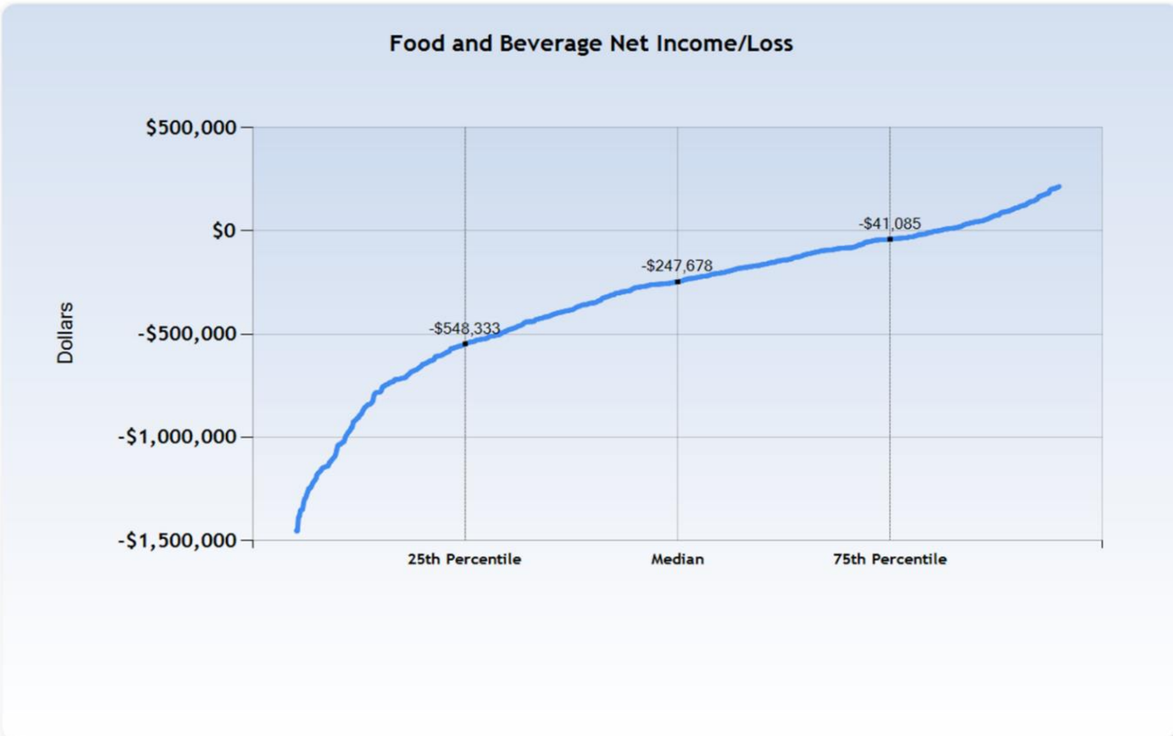
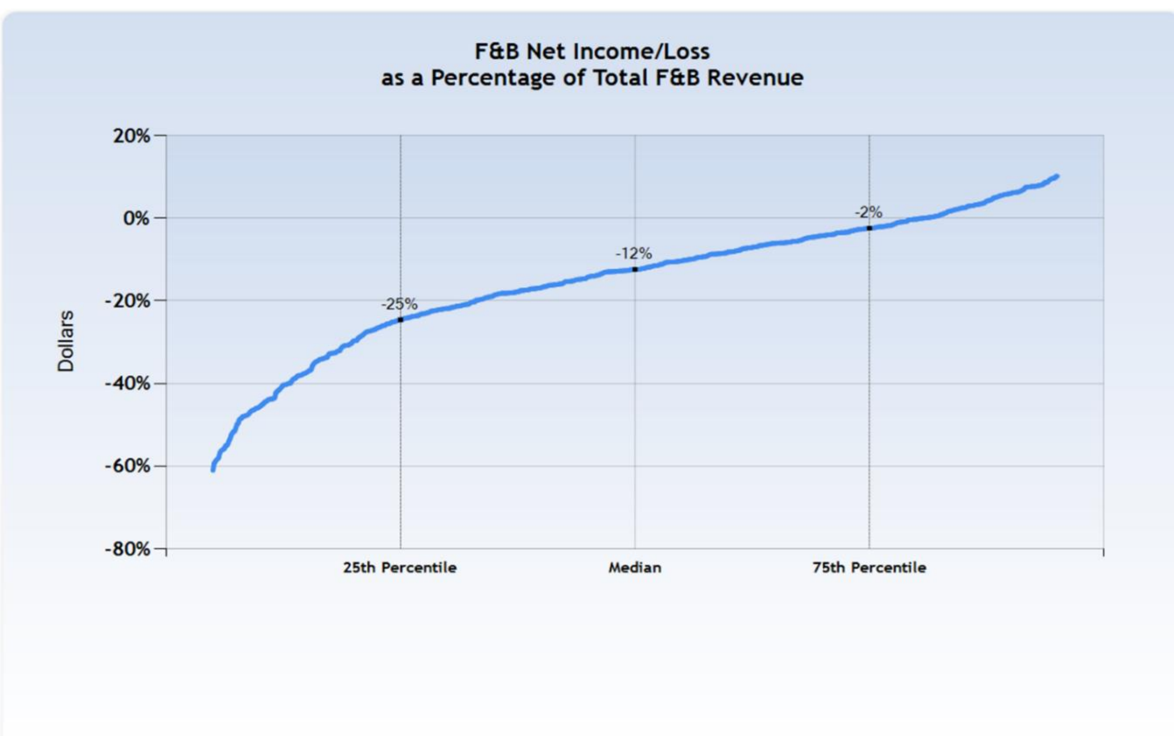


Chart 2 – Financial Result in Food and Beverage as Proportion of F&B Revenue



Both Charts 1 and 2 show the break-even point in F&B falling at the 80th percentile. To use common language heard in boardrooms, that means 80 percent of clubs "lose" money in F&B. Semantics are a key factor in the F&B trap. As such, Club Benchmarking advocates for a change in the terminology typically applied in discussion of F&B results. Loss implies something wrong, while subsidy implies a choice, which is the way it actually works. As a contextual reference, at a later point in this paper we will address the fact that 100% of clubs subsidize their golf department. Simply shifting the terminology (and perspective) from a "loss" in F&B to a "subsidy" of that amenity funded by dues revenue, as is done in golf, is an easy and significant first step in escaping the F&B trap. We suggest the words "loss" and "lose" be replaced with "deficit" and "subsidy" and the word "profit" be replaced with "surplus."

Table 1 – Certain Key Performance Indicators By F&B Bottom Line

Median	Lower Quartile (-25% of F&B rev and below)	2nd Quartile (-25% to -12% of F&B revenue)	3rd Quartile (-12% to -2% of F&B revenue)	Upper Quartile (-2% of F&B rev and above)
F&B Subsidy as % of Dues Revenue	-16%	-9%	-5%	3%
Overall Club Operating Margin	-0.1%	0.0%	0.2%	1.7%
Full Member Equivalents	511	498	506	452
Initiation Fee	$49,250	$25,000	$17,200	$10,000
Member's Equity	$14,042,000	$10,563,000	$6,965,000	$5,223,000
% of Clubs in Quartile Meeting Net Available Capital Ratio Target	40%	30%	30%	20%

Table 1, which references Chart 2 (data from 837 clubs), presents the four quartiles of F&B bottom line (deficit or surplus) as a proportion of F&B revenue alongside accompanying club Key Performance Indicators (KPIs) including F&B Subsidy as a proportion of Dues Revenue, Overall Club Operating Margin, Full Member Equivalents, Initiation Fee, Member's Equity, and percentage of clubs above the desired target for Net Available Capital (capital being the club's primary financial driver over time). For example, the lower quartile includes clubs with the greatest F&B deficits (ranging from a deficit equal to 25% of the F&B revenue to a deficit of 266% of F&B revenue). The upper quartile includes the clubs with small deficits and surpluses (ranging from a deficit of 2% of F&B revenue to a surplus of 36% of F&B revenue).

There are several observations that jump out of Table 1 that must be embraced:

1. Regardless of the F&B subsidy, clubs break-even operationally as evidenced by the Overall Club Operating Margin. Ninety percent of clubs set the operating ledger (aka

income statement) to break-even excluding depreciation (depreciation is a capital expense that manifests on the capital ledger). As communicated in previous Club Benchmarking white papers, the operating ledger is not a club's financial driver. The operating ledger is the vehicle for delivering services and amenities to the members. It is consumed every year by members enjoying the club.

2. The financial engine of a club is fueled by members. Clubs with more members are able to offer a broader, more compelling member experience as they have more money. The clubs with greater F&B subsidies have more members. The largest drop in membership count appears in the quartile of clubs choosing a slight F&B deficit or generating a surplus (these tend to be the clubs governed with the edict to not "lose" money in F&B).

3. Club Benchmarking analysis indicates the best quantitative marker for the overall health of a club is its initiation fee. It is both a key driver of capital income and the market's objective measure of a club's value proposition and member experience. Clubs with higher initiation fees have higher membership demand and clubs with lower initiation fees have lower membership demand. As shown in Table 1, clubs subsidizing F&B the most have much stronger membership demand than those generating a surplus from F&B as evidenced by the initiation fee.

4. Just as it is in every business, the ultimate measure of a club's financial strength is the equity on its balance sheet. Ultimately, Member's Equity on a club's balance sheet represents the scale of the property, plant and equipment the club owns (80 percent of the assets on the average club balance sheet is the net book value of property, plant and equipment). As can be seen in Table 1, Member's Equity is nearly three times greater in clubs with greater subsidies in F&B. Member's Equity is the measure of how well-positioned a club is in the market.

5. Finally, Net Available Capital is the amount of capital a club generates. It is the financial driver and the ideal target is to generate available capital that is equivalent to 18% or more of a club's operating revenue. As can be seen in the table, twice as many clubs with the highest F&B subsidies are meeting the ideal target. The reason is they offer a more compelling member experience, again evidenced by the initiation fee, one critical facet of which is the F&B experience.

The white paper could potentially end here without digging deeper. While it is likely not every reader agrees at this point that a subsidy of the F&B department is a choice rather than a problem, the evidence presented thus far should be compelling for objective readers. But let's dig deeper in the spirit of diligence.

The Driver of the F&B Result

The following several factors impact the financial outcome in F&B:

- Number of venues available for service
- Number of meal periods and service hours available
- Quality of food and beverage served
- Service levels – number of F&B personnel available to serve the members
- Pricing – many clubs set prices to target A La Carte to a 40% Cost of Goods but there is wide variation
- Mix of revenue between banquets and A La Carte

Each of the above factors represent a choice clubs make. Some clubs choose to have significant banquet revenue, actively seeking outside functions, weddings, etc. Other clubs choose to restrict banquet revenue to members-only. Some clubs choose to have one or two venues with restricted meal periods and service hours, other clubs choose to serve three meals per day, 365 days per year, even if only one person shows up for breakfast on a Thursday morning. Some clubs choose to offer huge buffets for a low price, other clubs choose to make a profit in every F&B offering. Some clubs choose to have a per chit gratuity, some clubs choose a level service fee, a few clubs choose to not have a service charge. In the end, such choices drive the outcome.

We put forth Monterey Peninsula Country Club (MPCC) as an example of how choices drive the outcome. In 2017, MPCC decided that the non-Cost of Goods (COGs) F&B expenses (labor, supplies, entertainment expenses, etc.) should be considered a fixed expense to be shared equally by all members, just as golf course maintenance is a shared expense. The dues were increased for every member to cover those expenses which allowed the club to shift away from covering the non-Cost of Goods F&B expenses through margin on sales of F&B. That freed the club to set menu prices at a mere 10% above the cost of goods. MPCC now operates at a 90% cost of goods for member a la carte dining. Menu prices dropped between 60% and 65%. For instance, a tremendous bone-in ribeye (Morton's quality) sells for $22. At Morton's it would sell for $84 and in MPCC's previous operating model (the typical club model of 40% COGs for a la carte dining) it would have sold for $55. High-end wines are now $9 and $10 per glass and a popular house wine is $4 per glass.

Member satisfaction at MPCC, already high prior to the change, has reached stratospheric heights. Member's usage of the club is energized, and a la carte cover counts (a measure of member usage of the F&B amenity) have more than tripled.

While the club's F&B "loss" increased significantly, the increased dues revenue more than covers the increased subsidy of the F&B deficit. The proportion of dues subsidizing F&B has gone from 15% to 33%. That was the choice the club made and everyone – Board, Finance Committee, membership, and staff – is aligned on this choice. The club has been made stronger, not weaker, by the decision. Obviously, the increased subsidy of F&B resulted from choice – not from inefficiency." The choice was to spread the non-COGs costs of F&B equally across the membership. On the other hand, in most clubs, given the reliance on margin to cover non-COGs costs, the heavy club users are subsidizing the F&B operation for the less regular users of the club. Does that make sense? Would that make sense in golf? What if after paying dues, members had to pay a greens fee as well? Then the avid golfers would be subsidizing golf for the less regular golfers.

The driver of the financial outcome in MPCC's F&B operation is clear: It is choice. The club's subsidy is a result of the choice to treat F&B purely as an amenity by covering expenses through a dues subsidy rather than margin on sales. That choice had a positive impact on member satisfaction. The cost of the F&B operation, just as with the golf operation, will be covered one way or another, either through a dues subsidy or through pricing that produces margin.

Margin versus Dues

Ultimately, the choice made across the club industry regarding F&B is whether to lean towards covering the non-COGs cost of F&B through margin on sales or through subsidy using dues. A bit later in this paper, we will demonstrate that course maintenance expenses are covered with dues as opposed to margin. The "head fake" that has occurred in clubs for far too long is confusing efficiency (or lack thereof) with making a choice to cover expenses using a dues subsidy instead of margin on F&B revenue.

Let's take two clubs as an example. Club A has an extensive number of lunch and dinner buffets every week with a vast spread of food; meat, fish, poultry, cheese, fruit, vegetables, starches, pizza, ice cream, pastries, etc. They charge each member $19.95 to partake. Club A also has a member event every other week with entertainment and themed dinners – Mexican, Italian, French, Mediterranean, Brazilian, etc. The club chooses not to charge members to cover all of the costs – they choose to offer their events at a low price to increase participation and satisfaction. On the other end of the spectrum, Club B is governed with the edict "don't lose money in F&B." If they have a buffet or a member event, the board and finance committee implore the staff to never "lose" money on either. The cost of the buffet or event must be covered by the price charged to partake. At Club B, the staff is constantly running reports to prove to the board and finance committee that their member events never "lose" money (this is a real example). A few questions in this regard:

1. Which club has more participation in the given offerings?
2. In which club are the members walking away thinking – "WOW – what a great deal that was. I love this club!"
3. Which club has the higher initiation fee (and dues) reflecting the increased value of being a member?
4. Which club is healthier financially?

The data shows Club A on all counts – Club A ***chooses*** to operate F&B on lower margin (as a result of lower prices and higher COGs due to more varied choice and higher quality). The lower margin results in Club A using more of its dues revenue to subsidize the non-COGs F&B expenses. It is simply a choice.

The primary goal of this white paper is to present the correct perspective of F&B. Club A makes a choice to increase the value offered to members through F&B programming. Their "loss" isn't a result of inefficiency; it is a result of that choice. If this white paper causes a widespread acknowledgement that F&B deficits are related to that choice, it has met its purpose. Clubs get to make the choice, please don't confuse the financial results in F&B with anything but that choice.

Chart 3 shows the distribution of the margin on F&B revenue (Margin = (Revenue – COGs) / Revenue) across the industry. The clubs on the left of the distribution lean toward covering more of the non-COGs F&B expenses through dues subsidies. The clubs on the right choose to cover those expenses through margin. Overlaid on the chart is the median Initiation Fee for each of the groupings alongside the median percentage of dues revenue allocated to subsidize F&B. The Initiation Fee reflects the market's objective assessment of a club's value proposition. The choice between margin and dues subsidy could not be clearer reading Chart 3 left to right. Again, please don't confuse the choice clubs make with efficiency. Clubs that lean towards treating F&B as an amenity – a service that delivers value to members – have higher initiation fees than the clubs that lean towards treating F&B as a profit center.

Chart 3 – Distribution of Margin on F&B and Associated Metrics

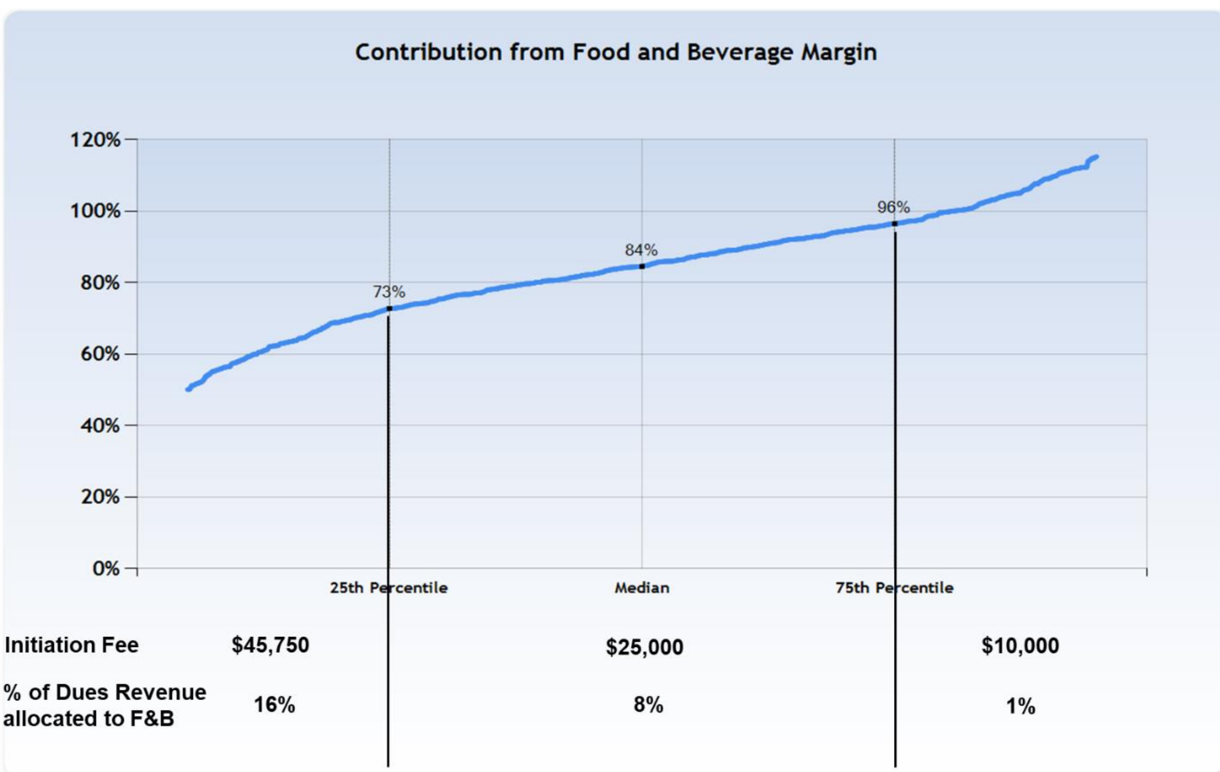


Chart 4 presents a club that has chosen to deliver significant value to its members via a la carte dining by covering non-COGs F&B expense through dues instead of margin as benchmarked against the average club which chooses mainly margin over dues.

Chart 4 – Approach to Covering non-COGs F&B Expenses

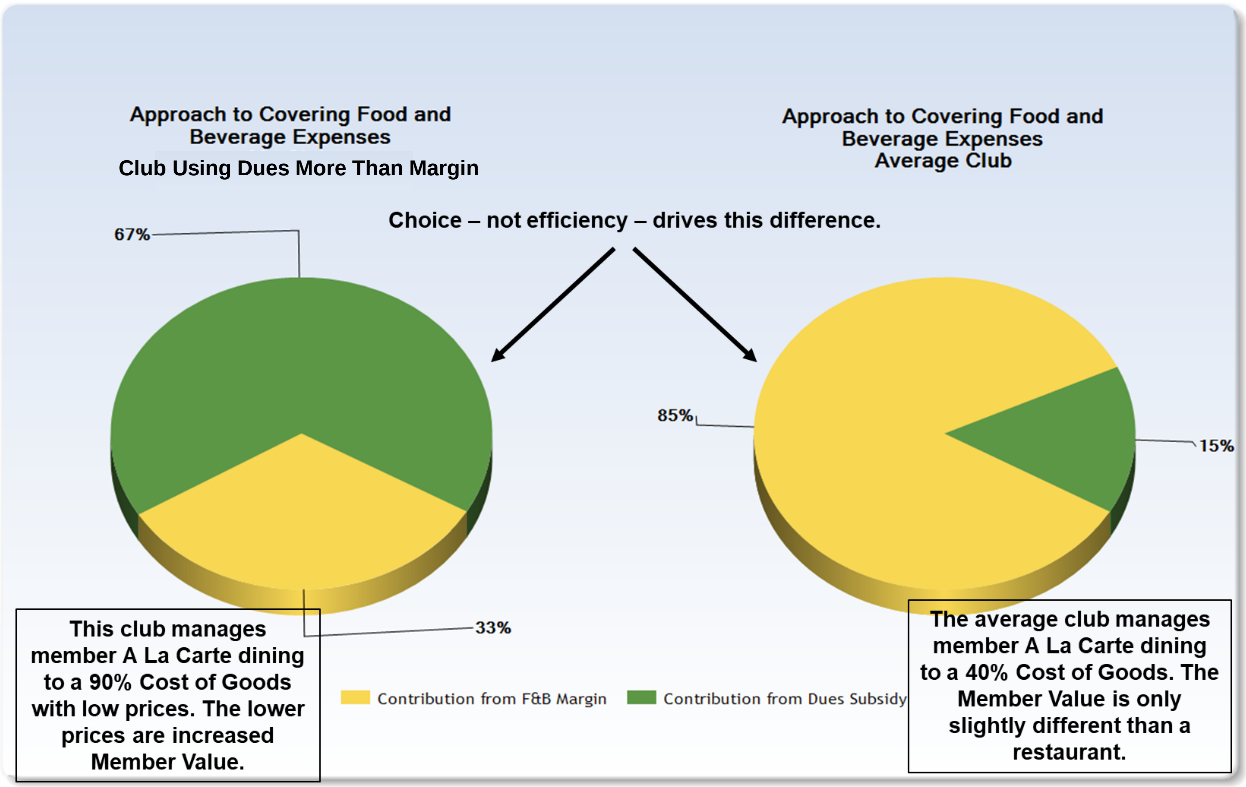


Table 3 presents Club Benchmarking's assessment of key pros and cons related to the choice of covering non-COGs F&B expenses through margin or through dues subsidies.

Approach to Covering F&B Expenses	Pros	Cons
Margin	1. Easier to explain the logic to naysaying members as subsidy of F&B runs counter to "conventional wisdom"	1. Heavy users subsidize expenses for light users. Expenses unequally shared. 2. Less value delivered to members. 3. Focus on F&B bottom line in board and Finance Committee takes focus away from the value proposition of the club.
Dues Subsidy	1. Expenses shared equally across membership. 2. More value delivered to members as evidenced by Initiation Fee. 3. Fosters a culture of "owner mentality" versus "customer mentality" 4. Allows board and Fincom to reduce discussion of F&B and focus on the Club's value proposition – the key to success. 5. Increased member satisfaction and better member experience.	1. The reason the dues are higher must be explained to the members.

In summary, the choice between covering F&B expense through margin or dues subsidies drives the bottom-line result in F&B – not efficiency or lack thereof. Each club can choose their approach, but that choice has consequences in relation to the member experience. Simply embracing the concept that the financial outcome in F&B is a result of choice over efficiency will make the dialogue in your club healthier and more strategic.

Why the Focus on F&B?

Club Benchmarking receives hundreds of calls a year from clubs inquiring about the "loss" in F&B. In 11 years, we have not received one single call inquiring about the "loss" in golf despite the fact that the golf "loss" is significantly greater.

Charts 4 and 5 below present the proportion of dues revenue applied to subsidize the F&B and golf. As can be seen, golf "loses" much more money than F&B requiring a much larger subsidy of dues. So why doesn't the discussion in the finance committee and/or board meeting regarding the loss in golf equal the constant discussion on the loss in F&B? The premise of this white paper is that it is a perspective issue. We are all familiar with F&B, we all eat out and we tend to apply an incorrect paradigm to the club's F&B

operation. While the support around the choice to spend money on golf is embraced, the opportunity for positive choices around F&B is missed. Public golf courses make money, and yet that point is never cited in meetings. Why isn't that a reference point? These questions are obviously rhetorical, but hopefully they will illuminate the flawed logic that Club Benchmarking asserts is at the root of the F&B trap.

Chart 4 – Proportion of Dues Revenue Subsidizing F&B

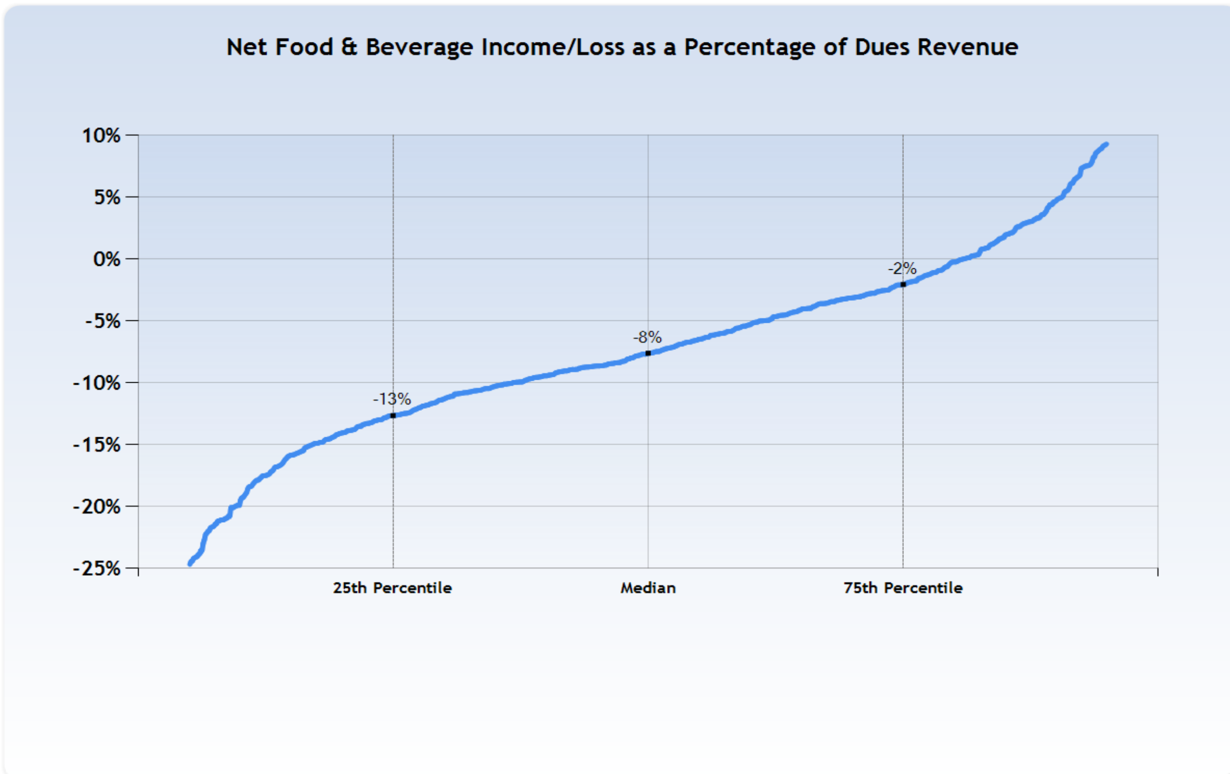
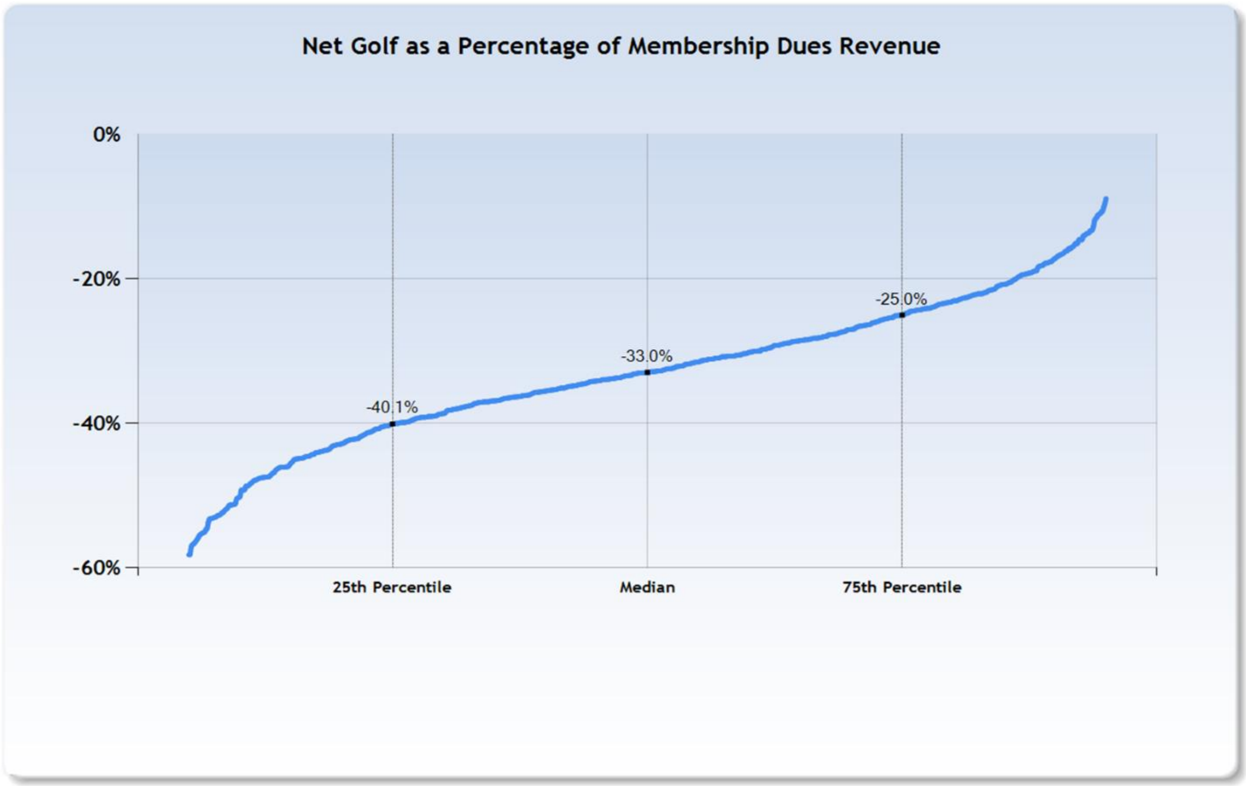


Chart 5 - Proportion of Dues Revenue Subsidizing Golf



The Fact-Based View of F&B

Data has been presented that demonstrates the financial outcome in F&B is a result of choice as opposed to a reflection of efficiency. That does not mean that every single club is exactly equivalent in terms of efficiency, but Club Benchmarking analysis shows less than eight percent of a club's overall operating expense is influenced by efficiency. The focus on F&B is misplaced – it is choice that drives the outcome and the impact of those choices is apparent. Clubs that choose to subsidize F&B the most have higher initiation fees, more members, more capital and higher member's equity. Clubs compete on value, not price. The MPCC story is about value. The ability to enjoy world-class F&B for 10 percent above the cost of goods instead of 400 percent as is typical in high-end restaurants (operating to a 25% COGs) creates tremendous value for MPCC members.

A fact-based discussion of F&B financial outcomes and the quality and service levels in clubs begins with the recognition that the outcomes revolve around choice, not efficiency. The "loss" in F&B at MPCC represents member value and satisfaction driven by a choice to cover F&B expenses using dues rather than margin on sale unlocking member value in F&B. It does not represent inefficiency or poor management. Every volunteer committee or board member would be doing their club a service to embrace this perspective rather than shunning it. <u>It is the fact-based perspective.</u>

The objective of ***every*** department in a club is to offer an experience that attracts members to the club and inspires member usage. The F&B department is no different. Clubs that are strongest overall financially make a choice to treat F&B as an amenity and to pay for the amenity as they pay for golf, by choosing to spread as much of the expense across all of the members equally via dues as opposed to making the heavier users cover the expense through margin. Five minutes studying Table 1 makes that concept clear.

What Topic Replaces the Subsidy Discussion and Debate?

When board and committee members cross the threshold of understanding the perspective shift put forth in this white paper, it can be a very significant moment for the club. The perspective shift at MPCC drove real innovation in terms of pricing and the decision to treat F&B as an amenity. It has produced more positive outcomes than can be mentioned here.

The data presented in this paper clearly indicates the discussion of F&B outcomes should shift from profit or loss and efficiency to focus on member satisfaction, member engagement, member enjoyment of a tremendous food and beverage program. The financial discussion should shift to understanding and driving net worth over time and to capital needs and resources. Just as the discussion in the greens committee centers on constantly improving the course and course conditions, the same discussion should occur in the house committee. Our focus should be on constantly improving our F&B amenity such that it is a magnet for members joining the club and for members using the club. In surveys dissecting the motivation to join private clubs and on member satisfaction, the F&B programming is consistently cited as a higher motivation than the golf experience (according to Club Benchmarking and the McMahon Group).

Innovation can come from a perspective shift. Steve Jobs proved that with the touch screen. MPCC proved that through the transformation of their F&B program. Every club can embrace innovation by embracing a fact-based shift in perspective. It is all about delivering member value in every department in the club, especially F&B.

If you are involved in club governance, hopefully the logic and data presented in this paper has impacted your perspective. You can either embrace the data and insight presented (which may be counter to your prior held beliefs) and help your club thrive, or you can shun the data. At the root of fiduciary obligation is adoption of data to make decisions. Shunning the data presented in this white paper is moving away from meeting fiduciary duty. The F&B operation in a private club is not a restaurant or a profit center – it is an amenity that is subsidized, like all amenities in the club, by membership dues. The club gets to choose the balance between the subsidy and the member experience – as is done in all amenities, including golf. The financial outcome is a result of that choice, not whether the operation is “efficient.” Clubs embracing F&B as an amenity, are more likely to have a successful club as evidenced by the data presented.