



# From RE-ACTIVE to PRO-ACTIVE

*Using Financial Analysis to  
Improve your Business*

ISPA Knowledge Network  
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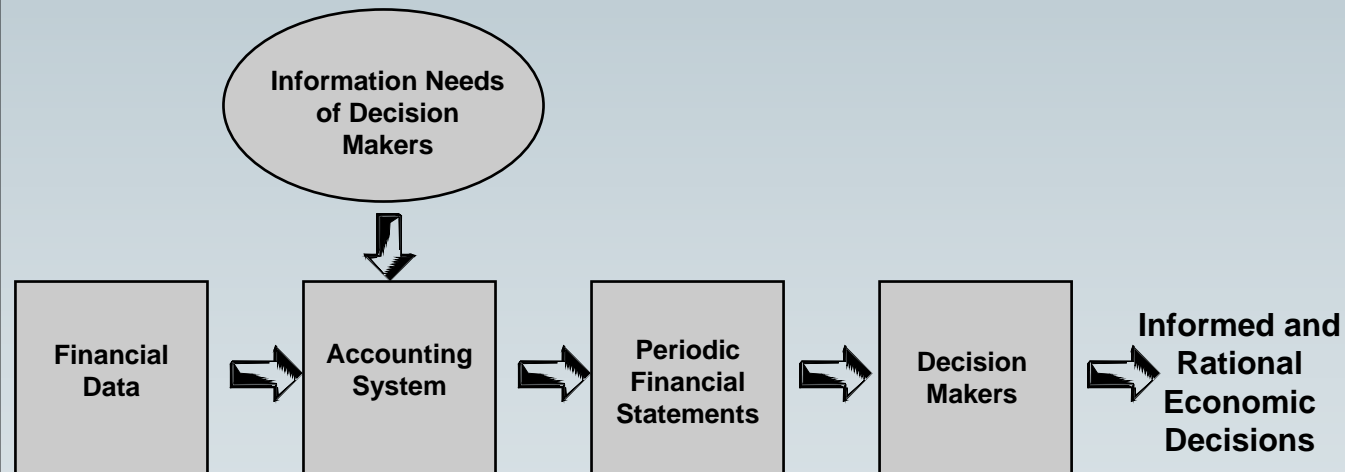
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# Expanded View of Accounting System



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# Key Inputs for Spa Accounting

- Revenues from services provided and merchandise sold
- Payments of employee salaries, wages and benefits
- Payments of expenses
- Costs of goods
- Undistributed Costs
- Fixed Costs



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# Key Components for Spa Accounting System

- Accounts
- Chart of accounts
- General ledger
- General journal
- Other journals and ledgers
- Accounting cycle



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# Primary Output for Spa Accounting System

To make the most effective use of financial statement data, decision makers apply various analytical techniques to that data, including;

- Preparation of common-sized financial statements
- Ratio analysis
- Trend analysis



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# Common Financial Statements

- Income Statement
- Balance Sheet
- Statement of Cash Flows



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# Income Statement Components

- Net Revenue
- Cost of Goods
- Direct Expenses
- Indirect Expenses
- Undistributed Operating Expenses
- Fixed Charges
- Depreciation, Amortization, Interest Expense and Income Taxes
- Net Income



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# Revenue Components

- Spa Services
- Salon Services
- Fitness Services
- Health and Wellness
- Medical Services
- Membership and Fees
- Retail
- Rentals and Other
- Food and Beverage



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# Cost of Goods Sold

- Cost of Retail Products
- Cost of Professional Products
- Cost of Food and Beverage
- Salaries and Wages
- Commission
- Payroll Taxes and Benefits
- Independent Contractor Fees
- Expenses directly related to the performance of service or sale of product



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# Payroll

- Salaries and Wages
- Commission
- Payroll Taxes and WC
- Benefits



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# Salaries and Wages

## Spa Positions

- Management and Supervisors
- Technicians
- Receptionists
- Attendants
- Housekeeping
- Fitness
- Stylists
- Nail Technicians
- Medical Staff



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# Direct or Indirect

- Expenses are either direct or indirect depending on the service performed or product sold
- Differentiated in order to understand where the cost occurred



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# Expenses

- Ambience
- Contract Services
- Dues and Subscriptions
- Equipment Rental
- Guest Supplies
- Hospitality
- Independent Contractor Fees
- Laundry
- Linen



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# Expenses

- License and fees
- Operating Supplies
- Professional Development
- Salary and Wages
- Telecommunications
- Travel
- Uniforms
- Others
- These expenses can crossover depending on what revenue source



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# Undistributed Operating Expenses

- General and Administrative
- Marketing
- Facility Maintenance and Utilities



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Full Time Employee  
1/1/2008

Current VLIFE: 0

Spouse  
Current VLIFE: 0

Amount of Coverage

Monthly Premium

Applying for: All coverage amounts subject to limitations/exclusions as stated in policy

Order to coverage

\$20,000  
\$40,000  
\$60,000  
\$100,000  
\$200,000  
OTHER \$

Selection above replaces current amount.

RETAIN CURRENT AMOUNT

\$10,000  
\$20,000  
\$30,000  
OTHER \$

Selection above replaces current amount.

RETAIN CURRENT AMOUNT

# Undistributed Operating Expenses

## General and Administrative Expenses

- Payroll and Related
- Accounting Expenses
- Other Expenses



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# General and Administrative Expenses

## Accounting Expenses

- Audit Expenses
- Payroll Processing



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# General and Administrative Expenses

## Other Expenses

- Bank Charges
- Cash Over/Short
- Credit and Collection
- Credit Card Commissions
- Dues and Subscriptions
- Human Resources
- Information Systems



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# General and Administrative Expenses

## Other Expenses

- Legal and Professional
- License and Fees
- Loss and Damage
- Meals and Entertainment
- Operating Supplies
- Postage
- Professional Development
- Travel



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# Undistributed Expenses

## Marketing Expenses

- Payroll and Wages
- Other Expenses
  - Advertising
  - Agency Fees
  - Collateral
  - Comp Guests
  - Direct Mail
  - Promotions



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# Undistributed Expenses

## Facility Maintenance and Utilities

- Payroll and Wages
- Utilities
- Other Expenses
  - Building
  - Contract Services
  - Equipment Rental
  - Equipment Repair
  - Landscaping
  - Operating Supplies
  - Trash Removal
  - HVAC



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# Fixed Expenses

- Insurance
- Management Fees
- Rent
- Real Estate
- Personal Property Taxes



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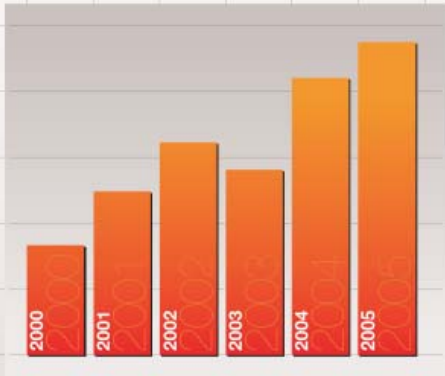


# Other Expenses

- Depreciation
- Taxes
- Interest Expense
- Amortization



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# Income Statement Defined

- A report that reflects the RESULTS of operations for a period of time.
- When the statement reflects a net loss, it is called a Statement of Operations.
- Degree of detail is somewhat discretionary, but should include revenue, expenses, interest, depreciation and taxes UNLESS amounts are insignificant.
- Format will depend on who is using the report.



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# Income Statement Defined

- External users such as owners, investors and creditors will use the Income Statement that is relatively brief, providing only a summary detail about the results of operations.
- Internal user's such as General Manager will use a much more comprehensive income statement detailing revenues and expenses from various departments.
- The internal user's such as Director's and Manager's will use a Departmental Income Statement.
- The Income Statement can also be referred to as the Profit and Loss Statement or P & L
- The Departmental P & L will usually not include interest, depreciation, and taxes.



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# Statement of Cash Flows Defined

- A report that summarizes the change in Cash and Equivalents over a period of time.
- The Cash Flow Statement shows how the company is paying for its operations and future growth, by detailing the "flow" of cash between the company and the outside world; positive numbers represent cash flowing in, negative numbers represent cash flowing out.



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	Period 1	Period 2	Period 3	Period 4	Total
<b>Beginning Cash Balance</b>	\$ -	\$ (27,887)	\$ (30,276)	\$ (35,973)	\$ (94,137)
<b>Cash In-Flows (Income)</b>					
Accounts Receivable	\$ -	\$ -	\$ -	\$ -	\$ -
Sales Receipts	\$ 66,023	\$ 111,607	\$ 105,950	\$ 131,406	\$ 414,985
Loan Proceeds	\$ -	\$ -	\$ -	\$ -	\$ -
Other	\$ -	\$ -	\$ -	\$ -	\$ -
<b>Total Cash In-Flows</b>	<b>\$ 66,023</b>	<b>\$ 111,607</b>	<b>\$ 105,950</b>	<b>\$ 131,406</b>	<b>\$ 414,985</b>
<b>Available Cash Balance</b>	<b>\$ 66,023</b>	<b>\$ 83,720</b>	<b>\$ 75,674</b>	<b>\$ 95,433</b>	
<b>Cash Out-Flows</b>					
Cost of Goods Sold	\$ 4,285	\$ 7,754	\$ 7,346	\$ 9,182	\$ 28,566
Salary and Wages	\$ 37,307	\$ 48,893	\$ 47,820	\$ 53,817	\$ 187,836
Independent Contractors	\$ 7,801	\$ 12,432	\$ 11,887	\$ 14,339	\$ 46,460
Operating Expenses	\$ 28,317	\$ 28,716	\$ 28,394	\$ 29,745	\$ 115,173
Subtotal	\$ 77,710	\$ 97,796	\$ 95,447	\$ 107,084	\$ 378,036
<b>Other Cash Out-Flows</b>					
Capital Purchases	\$ -	\$ -	\$ -	\$ -	\$ -
Loan Repayment	\$ 11,100	\$ 11,100	\$ 11,100	\$ 11,100	\$ 44,400
Owners Draw	\$ 5,100	\$ 5,100	\$ 5,100	\$ 5,100	\$ 20,400
Other	\$ -	\$ -	\$ -	\$ -	\$ -
Subtotal	\$ 16,200	\$ 16,200	\$ 16,200	\$ 16,200	\$ 64,800
<b>Total Cash Out-Flows</b>	<b>\$ 93,910</b>	<b>\$ 113,996</b>	<b>\$ 111,647</b>	<b>\$ 123,284</b>	<b>\$ 442,836</b>
<b>Ending Cash Balance</b>	<b>\$ (27,887)</b>	<b>\$ (30,276)</b>	<b>\$ (35,973)</b>	<b>\$ (27,851)</b>	<b>\$ (121,987)</b>



# Balance Sheet Defined

- Reflects the financial position of an operation by revealing assets, liabilities, and owners' equity as of a given date.



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# Balance Sheet Defined

Simply stated...

- Assets – Represent things owned by the spa
- Liabilities – Claims to the assets of outsiders
- Owners' Equity – Claims of the owners to the assets of the spa



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# Balance Sheet Defined

Simply stated...

$$\text{Assets} = \text{Liability} + \text{Equity}$$



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# How do these reports help us make decisions?

- Financial reports provide information about the performance or status of an operation for a given period of time
- Used to measure ourselves against set financial goals
- The information can be analyzed and compared to other departments, spas, industry averages, and like-businesses
- Data can be compared to the past to determine overall performance and predict the future
- Used to make changes in the business to increase performance



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# Types of Financial Analysis

- Trend Analysis
- Ratio Analysis



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## Trend Analysis

- A comparative analysis of a spa financial data over time.
- Helps us predict the future or understand the past
- Spa Data can consist of sales, expenses, payroll and profit.



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# Examples of Trend Analysis

- Comparative Analysis Over Time
  - Year over year
  - Quarter to Quarter
  - Month to Month
- Sources of data
  - Revenue
  - COGS
  - Expenses
  - Profit



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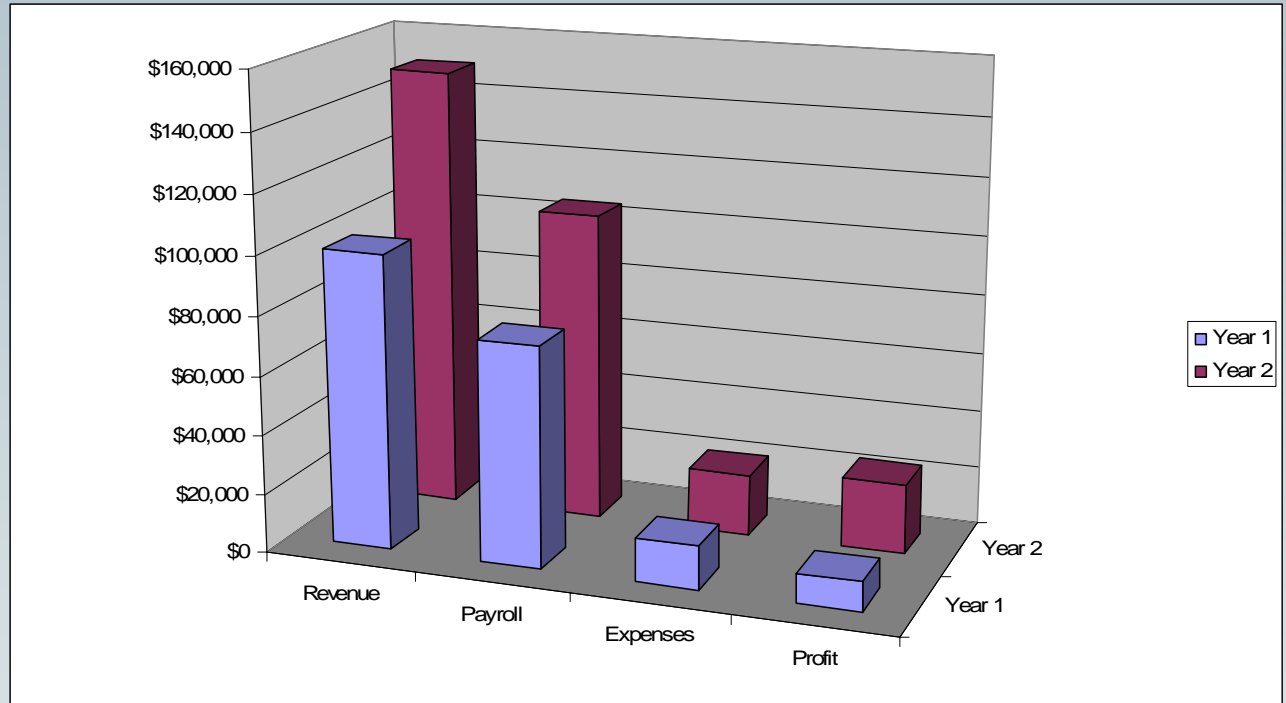
# Examples of Trend Analysis

	Year 1	Year 2	% Var
Revenue	\$100,000	\$150,000	?
Payroll	\$75,000	\$105,000	?
Expenses	\$15,000	\$21,000	?
Profit	\$10,000	\$24,000	?



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# Examples of Trend Analysis



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PAYROLL

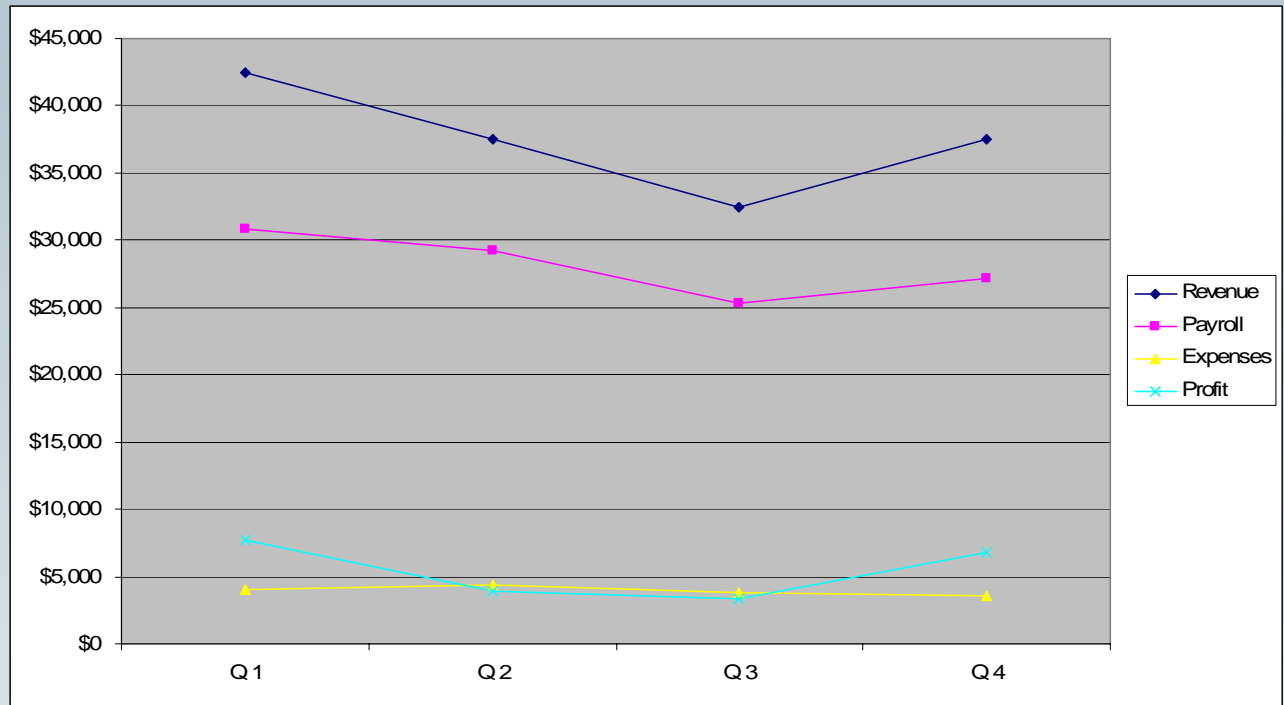
## Examples of Trend Analysis

	Q 1	Q 2	Q 3	Q 4
Revenue	\$42,500	\$37,500	\$32,500	\$37,500
Payroll	\$30,813	\$29,250	\$25,350	\$27,188
Expenses	\$4,006	\$4,344	\$3,767	\$3,534
<b>Profit</b>	<b>\$7,682</b>	<b>\$3,906</b>	<b>\$3,383</b>	<b>\$6,778</b>



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# Examples of Trend Analysis



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# Ratio Analysis

- Used as a basis for:
  - Comparison
  - Measurement
  - Communication
- Can yield meaningful insight into a spa's operational results and financial position
- Usefulness for comparing one spa to another is predicated on common definitions



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## Ratio Defined

- A ratio gives a mathematical expression to a relationship between two figures
- Calculated by dividing one figure by another



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## Ratio Defined

- Ratios are critical to any financial analysis, but are only indicators.
- As indicators, they are only meaningful when compared with useful criteria known as benchmarks



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# Benchmarks to Compare

- Ratios of other spas
- Industry averages
- Spa-specific historical ratios
- Spa-specific ratios



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# Spa Ratios

- Ratios do not in themselves resolve financial problems
- Problems or inefficiencies may exist when ratios vary significantly from:
  - Past periods
  - Budgeted standards
  - Industry averages
- If significant variances exist, investigation may be necessary to determine their causes and complete appropriate action



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# Spa Ratios

- When comparing ratios to other spas or industry averages, consider the following:
  - Facility size
  - Demand drivers
  - Location
  - Branding
  - Amenities



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# Financial Ratios

- Liquidity
- Solvency
- Activity
- Profitability
- Operating



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## Activity Ratios

*Activities Ratios measure the effectiveness with which management uses the spa's resources.*



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## Activity Ratios

- Inventory Turnover
- Utilization by Treatment Room
- Gross Margin Percentage



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# Activity Ratios

- Inventory Turnover
  - Measures the number of times inventory turns over during a period of time.
  - Owner's and manager's tend to like high rates because they are not tying up excessive assets in inventory.

Inventory Turnover =  $\text{COGS} / \text{Average Inventory}$



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# Inventory Turnover Example

A spa has a inventory balance of \$40,000 and \$20,000 as of June 1, 2005 and June 1, 2006.

The spa has COGS of \$150,000.

Inventory Turnover =  $\text{COGS} / \text{Average Inventory}$

$\$150,000 \text{ divided } \$30,000 = 5 \text{ times}$



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# Utilization by Treatment Room

- This ratio is essential in measuring a management's ability to utilize available resources.

Utilization =  $\frac{\text{Number of treatments performed}}{\text{Max number of treatments that can be performed}}$



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# Utilization by Treatment Room

## Example

- Assume a spa is open 9 Am to 5 PM, 7 days a week.
- There are 5 massage rooms.
- The spa sold 100 hours of massages.

8 hours per day X 5 massage rooms X 7 days

=

280 available treatments available



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# Utilization by Treatment Room

Example

200 hours of massage performed  
280 hours of available treatments available

=

# 71% utilization



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# Gross Margin Percentage

Used as a tool to determine if services should be discontinued or prices adjusted.

2 steps

**Gross Margin = Treatment Room Revenue – Treatment Room Direct Cost**

**Gross Margin Percentage = Gross Margin / Treatment Room Revenue**



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# Gross Margin Percentage Example

## Step 1 – Determine Gross Margin

**Gross Margin = Treatment Room Revenue – Treatment Room Direct Cost**

- A spa sells 100 the Sublime Facial at \$100.
- The COGS of the Sublime Facial is \$15.
- The commission associated with the treatment is \$35.

**\$100 Sublimes X 100 Sublimes = \$10,000 in Sublime Revenue**

**\$50 COGS X 100 Sublimes = \$5,000 Treatment Rooms Direct Cost**

**\$10,000 Treatment Revenue – \$5,000 Treatment Direct Cost =  
\$5,000 Gross Margin**



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# Gross Margin Percentage Example

Step 2 – Determine Gross Margin Percentage

Gross Margin Percentage = Gross Margin / Treatment Room Revenue

$$\frac{\text{\$5,000 Gross Margin}}{\text{\$10,000 Treatment Room Revenue}} = \text{50 \% Gross Margin}$$



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# Profitability Ratios

This ratio measures management's ability to produce profits by generating sales and controlling expenses.

$$\text{Profit Margin Ratio} = \text{Net Income} / \text{Total Revenue}$$



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# Operating Ratios

- This ratio helps owners and management to analyze spa operations.
- These ratios relate expenses to revenue.
- Common Operating Ratios:
  - Retail to Revenue Contribution
  - Labor Cost Percentage
  - Retail Cost of Goods Percentage
  - Cost of Professional Products and Supplies
  - Discounts and Coupons
  - Revenue per Occupied Hotel Room
  - Resort Capture Rates
  - Resort Market Segmentation Capture Rate



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# Operating Ratios

## Retail to Revenue Contribution

- This ratio measures retail sales contribution to overall spa revenue
- Management can use this ratio to determine if training or price adjustments are necessary

$$\text{Retail Revenue Contribution} = \frac{\text{Retail Revenue}}{\text{Total Revenue}}$$



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# Operating Ratios

## Labor Cost Percentage

- This ratio reveals management's ability to control labor costs in direct relation to overall revenue, treatments performed, or retail goods sold.

Labor Cost = Labor Expense/Total Revenue



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# Operating Ratios

## Labor Cost Percentage

- This ratio can be further broken down into labor cost percentage by service or retail sold.

Service Labor Cost = Service Labor Expense / Service Revenue

Retail Labor Cost = Retail Labor Expense / Retail Revenue



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# Operating Ratios

## Retail Cost of Sales Percentage

- This ratio measures the profitability of retail sales.
- Management can use this ratio as a tool to determine whether retail training or price adjustments are necessary.

Retail Cost of Sales =  $\text{COGS} / \text{Retail Revenue}$



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# Operating Ratios

## Cost of Professional Products Percentage

- This ratio measures the efficiency of product usage per treatment.
- Management can use this ratio to determine whether professional products are being used efficiently.
- Each treatment has an average cost of product per treatment that can aid in the day to day control of the direct cost of the treatment.
- The average cost is vital to tracking the profitability of a treatment before any other costs such as labor are allocated.

COPP = Cost of Prof. Products Used / Service Revenue



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# Operating Ratios

## Discounts and Coupons

- Discounts and coupons are used heavily in the spa industry to stimulate service and retail sales.
- Without careful analysis and frequent review, they can skew profitability comparisons for period to period.
- These ratios provide managers with the opportunity to monitor how revenues are affected by discounts and promotions.

$$\text{Average Retail Discount} = \frac{\text{Retail Discounts Given}}{\text{Total Retail Revenue}}$$



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# Operating Ratios

## Discounts and Coupons

Average Retail Discount =  $\frac{\text{Retail Discounts Given}}{\text{Total Retail Revenue}}$

Average Service Discount =  $\frac{\text{Service Discounts Given}}{\text{Total Service Revenue}}$



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COURTESY: MADISON SQUARE CLUB

# Operating Ratios

## Revenue Per Occupied Room

- This ratio measures the average amount of spa and fitness revenue generated by hotel guests.
- Management uses this tool to determine whether internal sales marketing is meeting its goal.

$$\text{REVPOR} = \frac{\text{Total Spa Revenue}}{\text{Number of Occupied Hotel Rooms}}$$



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# Operating Ratios

## Resort Capture Rate

- These ratios measure the percentage of hotel guests purchasing spa treatments or using the facilities.
- Management uses this tool to determine what percentage of guests are purchasing and whether additional measures are required to generate sales.

$$\text{Resort Capture Rate} = \frac{\text{Spa Guests}}{\text{Total Number of Hotel Guests}}$$



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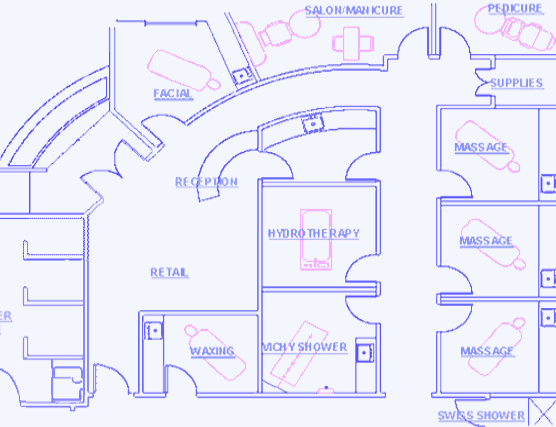
# Operating Ratios

## Resort Market Segmentation Capture Rate

- Management uses this ratio to determine which markets segments are using the spa and purchasing services.
- Once known, this information can assist management to adjust marketing strategies to generate additional sales to the particular market segment.
- Typical Market Segments for hotels are leisure guests, business travelers, non-incentive group guests, and locals. This can be further broken down into gender, zip code, etc.



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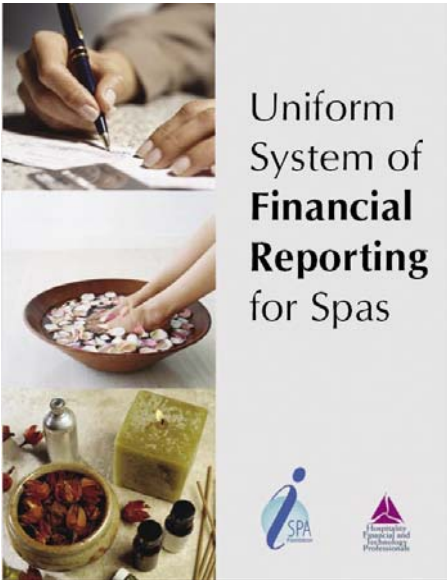
# Other Operating Ratios

Other Operating Ratios include:

- Revenue per Square Foot
- Average Service Revenue per Guest
- Average Retail Revenue per Guest
- Average Revenue per Employee
- Average Dollar per Transaction



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# Sources

- *Uniform System of Financial Reporting for* by the International Spa Association, Lexington, Kentucky 2005



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