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## Club Capital Budgeting Practices over Four Decades

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### ABSTRACT

The approach clubs take to evaluate capital budgeting projects has evolved over the years. This study provides evidence that clubs appear to continue favoring the payback approach to capital budgeting. In addition, the internal rate of return approach appears to be used more than in the past when evaluating projects. The study compares club capital budgeting practices over a four-decade time frame.

**Keywords:** *capital budgeting, clubs, internal rate of return, net present value, payback*

### Introduction

A budget is a financial plan for a club covering a period of time, stated in dollars. It is used to assist managers in controlling the acquisition and use of the financial resources of the club. Christensen, Hobson, and Wallace (2017) stated that two major budgets usually result from the budgeting process, namely, the annual operating budget and the capital expenditures budget.

Most of the annual expenditures of a club are referred to as revenue expenditures because they are expensed against the revenue of the period in which they are incurred. The usefulness of these expenditures are less than one year. These expenditures are included in the club's operating budget. Examples of these expenditures include items such as cost of food, beverages, wages, and supplies.

Capital expenditures, on the other hand, involve spending on projects whose lives are greater than one year. Schmidgall and Damitio (2001) stated that a club's capital budget relates to the plan to acquire items such as equipment, land, or buildings. These items are included in a club's capital budget. Horngren, Datar, and Rajan (2015) described capital

budgeting as the process of making long-term decisions for investments in projects.

Sometimes the classification between whether an expenditure is revenue or capital is blurry. Schmidgall, Damitio, and Singh (1997) studied financial executives in the lodging industry and the discernment between revenue and capital expenditures. They found that more than 50% of the respondents indicated that, at times, they had difficulty in the discernment process and believed that guidelines needed to be established to help them in that process.

Connolly and Ivey (2004) indicated that when economic conditions take a downturn, hospitality managers are generally forced to tighten their budgets. This, they stated, leads to a more detailed examination of proposed capital budgeting projects and the need for more sophisticated techniques to evaluate those projects.

The commonly used methods of capital budgeting include net present value (NPV), internal rate of return (IRR), payback (PB), and accounting rate of return (ARR). Kim and Farragher (1981) studied the capital budgeting practices of Fortune 100 companies and found a continuing trend toward greater use of IRR and NPV as primary techniques.

They found that PB was still important but was usually used as a secondary evaluation technique.

Graham and Harvey (1999) surveyed 392 CFOs from Fortune 500 companies on the use of capital budgeting methodology and found that large firms relied heavily on IRR and NPV while smaller firms were more likely to use PB. Ryan and Ryan (2002) studied Fortune 1000 companies and found that capital budgeting decisions were the most important ones that those financial managers faced. In that study, they found that the NPV method was the most popular method, followed by the IRR method.

It is interesting to examine the trends in capital budgeting globally. Kalyebara and Ahmed (2011) examined the top 500 companies listed on the Australian Stock Exchange. The majority of respondents used NPV and IRR. They also found that PB was commonly used as a screening technique for capital budgeting projects.

Maroyi and Poll (2012) examined the practices of South African mining companies concerning capital budgeting. Their results indicated the most commonly used method was NPV, followed by IRR, and lastly PB. Insight into capital budgeting methodology used in Europe is provided by Rossi (2015). That study provided knowledge into the common pitfalls that could be encountered in defining the cost of capital rate used in discounted cash flow models of capital budgeting.

How do the capital budgeting practices of hospitality firms generally compare to those of either global companies or Fortune 500 corporations? A study was conducted by Eyster and Geller (1981) that examined the capital budgeting practices of both lodging and restaurant companies for 1975 and 1981. Although PB appeared to be the most popular method at the time, they found a modest use of discounted cash flow models (DCF). Schmidgall and Damitio (1990) did a follow-up study of the lodging segment of the hospitality industry's practices. That study showed significant increases in the use of IRR and NPV methods of capital budgeting.

Other studies focused solely on the club segment of the hospitality industry and the capital budgeting practices of these entities. In the 1980s, a study of private clubs was conducted by Schmidgall (1986), and that study reported that 30% of the respondents had not examined the cost/benefits of their capital

projects. Of the respondents that employed formal techniques for capital budgeting, about 46% used PB, 28% used NPV, and 19% used IRR, while 7% used a combination of approaches.

Schmidgall (1998) conducted a similar study in the 1990s that involved clubs and their practices. That study found that 35% used NPV and 18% used IRR, suggesting a greater use of the DCF models in the 1990s.

Damitio and Schmidgall (2006) studied capital budgeting practices at clubs in 2006 and found that 43% of the clubs used PB, 25% used NPV, 17% used IRR, and 15% used a combination of studies. Thus, the club industry continued to rely highly on PB.

## Research Methodology

A survey instrument was designed to study the current capital budgeting practices of private clubs. It was sent to 2,400 members of the Club Managers Association of America (CMAA) who were identified as general managers. In total, 409 were returned for a response rate of 17%. The survey began with a number of demographic questions that included the following: title of the respondent, type of club, size of club in annual gross revenues and number of members, and lastly the profitability of the club.

The portion of the questionnaire that dealt with capital budgeting practices asked the following questions:

1. Does the club undertake a formalized cost/benefit study prior to acquisition of property and equipment?
2. If a formalized study is used for only major items, what is considered major?
3. If a formalized cost/benefit study is made, what capital budgeting approach is used?
4. If the payback approach is used, what is the maximum allowable payback period?

## Findings

### Demographics of Respondents

Of the 409 respondents, about 85% of the respondents held the title of general manager, while the rest of the respondents held other titles such as club manager or assistant manager. About 74% of the

respondents were employed by country clubs, while the remainder were managers of city clubs, yacht clubs, or other types of clubs. The size of the club varied, with the largest percentage (43%) having annual revenues of between \$5 and \$10 million, followed by 22% employed by clubs with annual revenues in excess of \$10 million. The third largest category (19%) of respondents reported annual revenue of between \$3 and \$5 million. Table 1 Part A below provides additional information on dollar size of respondents' clubs.

Part B of Table 1 reports the size of club in number of members, with the largest percentage (35%) having between 250 and 500 members. The profitability of the clubs based solely on food and beverage operations is shown in Part C of Table 1.

### Research Results

Of the respondents, 85% reported that their club performed some type of cost/benefit study prior to acquiring property and equipment. Marked differences were evident among respondents as to how that study was conducted; for example, 30% indicated that they did a study but only informally. While 25% did a formal study for all items, including

both new and replacement, 30% performed a formal study only for major new acquisitions while about 15% did not perform a formal or informal study.

The demographics of the respondents as to the use of cost/benefit analysis of capital budgeting projects are shown in Table 2, and no significant statistical differences were found with regard to size of club in annual revenues or size in members or in relation to club profitability. However, type of club revealed a significant statistical difference in terms of whether a study is prepared. A formal study was conducted at 55% of the country/golf clubs, while 52% of all other clubs conducted a formal study.

Table 3 shows cost/benefit studies by size of club based on annual revenues. It reveals that for the smallest clubs, those with annual revenue of less than \$2 million, only 13% did not perform a study for capital projects. For those clubs with annual revenues of between \$2 and \$3 million and \$3 and \$5 million, the percentage not conducting a formal study is 15% and 17%, respectively. For clubs with sales over \$5 million, 12% do not prepare a cost/benefit study for capital projects. Twenty-seven percent of the clubs with sales of less than \$2 million perform a study for all projects, while it is 23% for clubs with sales of between \$2 and \$3 million, 26% for clubs with sales of between \$3 and \$5 million, and 24% for clubs with sales over \$5 million. Fifty-seven percent of the largest clubs (annual revenues greater than \$5 million) conducted a study of either only major items or all items, compared to slightly smaller percentages for clubs of other sizes.

The percentage of clubs that conduct cost/benefit studies by size of club in members is shown in Table 4. Although it is not statistically significant, the largest clubs, over 1,000 members, had the highest percentage of respondents (37%) that did a study for major items only. The table also shows that for clubs of all member sizes, the percentage doing a study for all items is about the same, ranging from 21% to 28%. Just over 30% of the club executives

**Table 1.** Selected Demographics of Clubs

Part A: Size of Clubs (Revenues)	
Annual Revenues	Percentage
<\$2,000,000	6%
\$2,000,001–\$3,000,000	10%
\$3,000,001–\$5,000,000	19%
\$5,000,001–\$10,000,000	43%
>\$10,000,000	22%
Total	100%
Part B: Size of Clubs (Number of Members)	
Number of Members	Percentage
<250	5%
250–500	35%
501–750	25%
751–1,000	16%
1,001–2,000	12%
>2,000	7%
Total	100%
Part C: Profitability of Clubs	
Profit Margin	Percentage
>5%	22%
0.01%–5%	11%
–5%–0%	39%
<–5%	28%
Total	100%

**Table 2.** Comparison of Demographics in Whether Study Is Prepared

	Chi Square	Significance
Type of Club	38.025	0.060*
Size–Revenues	10.050	0.505
Size–Members	21.420	0.542
Profitability	9.598	0.583

\* Statistically significant at the 10% level

**Table 3.** Conduct of Cost/Benefit Studies by Size of Club (Annual Revenues)

	Size of Club (Annual Revenues)			
	<\$2 million	\$2 to \$3 million	\$3 to 5 million	>\$5 million
No Study Conducted	13%	15%	17%	12%
Only Informal Study	33%	35%	29%	31%
Study—Only Major Items	27%	27%	28%	33%
Study—All Items	27%	23%	26%	24%
Total	100%	100%	100%	100%

indicated that their clubs performed a formal study for major items only.

So what is considered to be a major item in terms of the size of the expenditure? The choices provided were expenditures over \$1,000; \$10,000; \$50,000; \$100,000; \$250,000; \$500,000; and other. Eleven percent of the financial executives indicated any capital expenditure of over \$1,000. The largest response was 47% indicating an expenditure over \$10,000, followed by 19% indicating an expenditure over \$50,000. Eight percent indicated an expenditure over \$100,000, and fewer percentages were revealed for other amounts. Table 5 reveals that there was not any significant differences between what is considered major and the demographics of type of club, size in annual revenues or size in members or profitability of the club.

The most common capital budgeting approach reported was PB used by 40% of those responding. Eighteen percent of the respondents used IRR while 14% used NPV when conducting a formal cost/benefit study. Four percent used other approaches.

**Table 4.** Conduct of Cost/Benefit Studies by Size of Club (Number of Members)

	Size of Club (Number of Members)				
	All	<500	500–750	751–1,000	>1,000
No Study Conducted	14%	19%	7%	13%	13%
Only Informal Study	30%	30%	33%	37%	25%
Study—Only Major Items	31%	26%	32%	29%	37%
Study—All Items	25%	25%	28%	21%	25%
Total	100%	100%	100%	100%	100%

**Table 5.** Comparison of Demographics in “What is Major?”

	Chi Square	Significance
Type of Club	26.014	0.352
Size—Annual Revenues	17.264	0.837
Size—Members	40.857	0.089
Profitability	16.010	0.592

Twenty-four percent of the clubs used a combination of approaches such as PB and NPV or NPV and IRR. When comparing certain demographics to the use of a capital budgeting approach, there is a statistically significant difference with regard to type of club as shown in Table 6.

As shown in Table 7, country/golf clubs are more likely to use IRR as revealed by club executives of 20% of the country/golf clubs and only 12% of respondents from other clubs. On the other hand, 32% of other clubs use a combination of approaches compared to 23% of the country/golf clubs.

A final question asked of respondents was “If the payback approach is used, what is the maximum allowable period?” The most common response from 48% of the club executives was five years. Only 2% responded with two years, 20% with three years, and 13% with four years. The remaining respondents (17%) indicated it depends on the life of the fixed asset; that is, the longer the life expectancy, the greater the allowable payback period. There were no statistically significant differences based on the four demographic factors.

**Table 6.** Comparison of Demographics in Capital Budgeting Approach

	Chi Square	Significance
Type of Club	49.902	0.007*
Size—Revenues	24.152	0.673
Size—Members	45.458	0.111
Profitability	22.647	0.363

\* Statistically significant at the 5% level.

**Table 7.** Capital Budgeting Approach and Type of Club

Type of Club	Number	PB	IRR	NPV	Combination	Total
Country/ Golf Club	121	43%	20%	14%	23%	100%
Other Clubs	25	40%	12%	16%	32%	100%

## Comparison to Prior Studies

Except for the 1985 study, the percentage of clubs that conduct cost/benefit studies has been very consistent for the studies conducted in 1995, 2006, and the current study, and remarkably consistent when examining the data from the 2006 study and the current study. Table 8 shows that in both the 2006 study and the current study, the percentage of respondents that did a study for all items was 45%, while the same percentage was found for clubs that did a major study for major items only, namely 55%.

How the categorization of "What is a major purchase?" differs among the four studies is shown in Table 9. The "Greater than \$1,000" category has declined from a high in the 1996 study to 25% in the 2006 study, to 11% in the current study. On the other hand, the category "Greater than \$10,000" has increased from 35% of the respondents in the 1996 study to 44% in the 2006 study, to 47% in the current study. The category "Greater than \$50,000" which had been consistently at 13% through the first three studies has increased to include 19% of the respondents in the current study. The "Other" category includes specific responses other than the four categories discussed above. It includes responses such as "Greater than \$250,000," "Greater than \$5,000," and "Over \$25,000."

Table 10 reveals the percentage of respondents using PB for cost/benefit studies has remained very consistent over the four studies, remaining in the low to mid-forty percent range. It also shows that there

**Table 8.** Clubs Conducting Cost/Benefit Studies

	Prior Studies			
	1985	1996	2006	Current Study
Percentage Conducting Study	70%	85%	82%	85%
Study—For All Items	19%	50%	45%	45%
Study—Only Major Items	81%	50%	55%	55%

**Table 9.** Size of Major Purchases

	Prior Studies			
	1985	1996	2006	Current Study
Greater than \$1,000	40%	46%	25%	11%
Greater than \$10,000	37%	35%	44%	47%
Greater than \$50,000	13%	13%	13%	19%
Greater than \$100,000	—	—	8%	8%
Other	10%	6%	10%	15%
Total	100%	100%	100%	100%

has been a decrease in the use of NPV and a slight increase in the use of IRR, which was reportedly being used by 17% of the respondents in the 2006 study and 18% in the current study. The major change over the four decades has been the use of a combination of approaches. Near the end of the prior century, only 7% (1985 study) and 5% (1996 study) used a combination of approaches. The 2006 study revealed 15% of the clubs used a combination of approaches, and the current study shows an increase to 28%.

The percentage of respondents who reported two, three, four, and five years as the length of the maximum allowable payback period in the current study is very consistent with the 2006 study as shown in Table 11. However, both the 2006 study and the current study show marked differences in those same choices when compared to the studies done in 1985 and 1996. The length of maximum allowable payback of five years was reported by 48% of the respondents in the current study compared to 44% from the 2006 study.

## Major Findings over Four Decades and Implications

Since considerable amounts of funds are spent on capital improvements, good financial practices include conducting cost/benefit studies prior to

**Table 10.** Capital Budgeting Approach Used

	Prior Studies			
	1985	1996	2006	Current Study
PB	46%	42%	43%	40%
NPV	28%	35%	25%	14%
IRR	19%	18%	17%	18%
Combination/Other	7%	5%	15%	28%
Total	100%	100%	100%	100%

**Table 11.** Length of Maximum Allowable Payback Period

Years	Prior Studies			
	1985	1996	2006	Current Study
2	8%	14%	3%	2%
3	19%	35%	19%	20%
4	12%	8%	14%	13%
5	61%	27%	44%	48%
Other**	—	16%	20%	17%
Total	100%	100%	100%	100%
Average*	4.26 years	3.57 years	4.24 years	4.28 years

\* Excludes other.

\*\* Depends on life of item purchased.

deciding in favor of the proposed acquisitions. The percentage of clubs conducting cost/benefit studies was only 70% in the 1980s and has been fairly consistent over the next three decades, varying from 82% to 85%, only three percentage points. Certainly, 85% of clubs conducting a study is much improved over the 1980s; still one wonders why all clubs are not conducting studies.

For clubs that do conduct studies, 45% conducted studies for all capital acquisitions, while 55% conducted studies for only major items for the most recent (2006 and 2018) studies. The authors agree that when insignificant amounts, as defined by a club, are spent that a formal cost/benefit study may not be justified.

The definition of *major* has changed over time. The largest group of club executives in the first two studies indicated major was considered "Greater than \$1,000." The most common response in the 2006 and current studies was "Greater than \$10,000." This trend is expected to continue; that is, the amount defined as major will grow over time.

Clubs have used several different capital budgeting approaches over the past four decades. PB continues to be the most used approach. However, 46% of the clubs used PB only in the 1980s, and during the current decade, 40% are using PB when a single approach is used. A significant change in the approach used is the use of a combination of approaches. Near the end of the 20th century, less than 10% of the club executives indicated a combination of approaches were used, and now 28% of the respondents indicate a combination. Again, we expect this trend to continue.

Since PB has been the most commonly used capital budgeting approach, club executives were queried over these four studies in regard to the maximum allowable payback period. In the initial study (1980s), the most common period was five years. The next study (1990s) showed the most common period was three years. The last two studies conducted in the 21st century reveal fairly similar responses, with five years being the most common response.

Overall, capital budgeting practices over the past four decades have changed only marginally. Club executives should be encouraged to conduct cost/benefit studies for all proposed capital projects when significant spending may occur. Further, club executives should be encouraged to use the more

sophisticated discounted cash flow approaches of NPV and/or IRR.

Two major approaches should be used to educate club executives in regard to capital budgeting. First, capital budgeting articles should be published in club industry/professional magazines including both *Club Management*, read primarily by club managers, and the *Bottom Line*, read primarily by club financial executives. In addition, capital budgeting presentations at conventions held by CMAA and HFTP would be useful in further educating these club executives.

Another means of education would involve including capital budgeting in hospitality management courses taught by professors in hospitality programs throughout the United States and the rest of the world. The results of these studies should be shared as well as the capital budgeting approaches. The more educated tomorrow's future managers, the more likely the greater the use of capital budgeting approaches in the future.

### Limitations of Study

Only members of CMAA were surveyed. Although this represents 2,400 clubs primarily in the United States, still there are clubs whose executives do not belong to CMAA. Therefore, we cannot generalize our findings to all clubs. Even though just over 400 club executives out of 2,400 responded, as researchers we wonder if more had responded, would our results be different? Club executives from other countries were not surveyed, so this study's results are limited to U.S. clubs.

### Future Research

The limitations above present opportunities in the future. U.S. clubs other than those with executives who are members of CMAA should be surveyed regarding their capital budgeting practices. Further, clubs throughout the world should be surveyed.

The other major segments of the hospitality industry include both the lodging and food service industries. How do budgeting practices differ from practices in the club industry? Further, future research could reveal how capital budgeting practices differ among the segments of these other hospitality industries.

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