

Management Accounting
(LCBB5002)

ASSIGNMENT 1
ESSAY

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Introduction

Management accounting is one of the main strands in accounting concerned with providing financial and non-financial information to managers within an organization to improve decision-making processes and enhance company's effectiveness and efficiency. Unlike financial accounting, management accounting is future oriented, making possible processes as planning, controlling and performance measurement. (Atrill and McLaney, 2018)

For managers, an essential part of decision making is understanding cost behaviour – how costs and revenue vary with a change in the activity levels. According to their behaviour, costs could be fixed or variable. Fixed costs are those which remain constant over a wide range of activity. Total fixed cost does not depend on changes in the activity levels, however, fixed cost per unit decreases respectively with a change in activity level. Variable costs are those varying proportionately with changes in activity. Total variable costs increase/decrease in proportion to volume of activity, whereas variable cost per unit remains constant, unaffected by levels of activity. (Drury, 2012)

The COVID-19 pandemic is having a destructive impact on almost all industries across the globe, with hospitality being one of the hardest hit sectors. The drastic measurements taken by governments to control the spread of the virus had forced restaurants, hotels, bars and many other leisure amenities to remain closed. In result, the sector is experiencing a dramatic fall in revenues and financial instability. (Uğur and Akbıyık, 2020) High levels of uncertainty and the unknown duration of the COVID outbreak compelled managers and owners to reconsider their strategic approaches and seek innovative ways to cope with the consequences. (Anguera-Torrell and Aznar-Alarcón, 2020)

Harriot Hotel

Established in 1941 by John Brockville, Harriot Hotel has become one of the leaders in the hotel industry across the world, operating mainly in the Americas, Europe, Asia and Africa. Despite its continuous expansion during the years, Harriot's CEO stated that due to the Covid-19 pandemic, 2020 was the worst year of the hotel's history. To reduce the losses and to deal with the financial impact of the pandemic, senior management decided to employ a cost-cutting strategy.

Projected Cost Breakdown for UK Division

Item (£m)	Value	As a percentage of revenue
Revenue	60,000	
Employees wages	15,000	25%
Advertising cost	7,000	12%
Interest on loans	10,000	17%
Housekeeping and cleaning supplies	5,000	8.3%
Customer discounts	8,000	13.3%
Stationeries used in front desk and restaurant	3,000	5%

Employees wages

Employees wages represent 25%, a significantly large share of Harriot's revenue. By spending quarter of their operating costs for employees' wages, Harriot Hotels confirm that the hotel sector is labour-intensive. (Vij, 2012) Although, during a global pandemic such a large share does not seem suitable to manage financial consequences.

Under the cost item Employee wages might be considered both fixed and variable costs, because hotel labour comprises both fixed and variable cost components. (Rushmore and O'Neill, 2014) Lower-level staff salaries (e.g. front desk performers, housekeeping staff, cooks) correspond to variable costs, as they are usually hourly paid. Instead, senior managers, HR managers and other senior staff members generally have fixed term contracts, relating to fixed costs. As senior members' salaries represent larger proportion of the total amount of wages paid, this indicates that higher percentage of employees' wages is fixed cost.

An appropriate recommendation for Harriot Hotels would be to reduce their management staff, by offering them to take an advantage of the UK government Coronavirus Job Retention Scheme – Furlough, which allows them to remain on the payroll, receiving an average of 80% of their salaries. The extended scheme could help Harriot Hotel reduce their fixed costs expenses, as they would not be required to pay any contributions to furloughed employees. (Chartered Institute of Personnel and Development, 2021)

Advertising cost

Advertising cost is 12% of revenue, which means Harriot hotels spend about one eighth of their budget on advertising.

This cost item is fixed in its nature since a fixed amount of funds is decided at a discretion by senior managers over a certain period of time, depending on the total budget. (Atrill and McLaney, 2018) Although advertising costs may vary over different periods of time, it is considered to be fixed as it does not depend on changes in hotel's level of occupancy.

As spending on advertising has a positive impact on hotel sales performance (Assaf *et al.* 2015), it is advisable for Harriot Hotels to consider increasing the advertising cost to foster customer awareness and brand loyalty, thus resulting in higher sales volume and increasing profitability. (Drury, 2012) A study conducted by Assaf *et al.* (2015) also demonstrates that increasing advertising spending boosts revenue.

Interest on Loans

Interest on Loans is 17%, representing the second largest expense for Harriot Hotel after Employees Wages. In the context of global pandemic this figure, corresponding to one sixth of the revenue, seems quite high.

The cost item 'Interest on loans' is a fixed as it is not affected by hotel occupancy levels, even with the current pandemic, when the occupancy levels of hotels are significantly low or nil, interest on loans still need to be paid.

It could be recommended Harriot Hotel to decrease those costs by applying for a loan with lower interest rates, thus the current loan could be paid off in full and the expenses on interest could be reduced by half. Another option for Harriot Hotels to cut down this cost could be asking lenders to extend the length of the current loan which will result in lower interest rates and will undoubtedly ease the financial difficulties caused by Covid-19.

Housekeeping and cleaning supplies

Housekeeping and cleaning supplies are 8.3% of revenue, meaning that Harriot Hotels spend one twelfth of their income on cleaning supplies, which is quite reasonable with the increased safety precautions due to the coronavirus pandemic.

This cost item may be defined as variable in nature, because it proportionally increases/decreases with the levels of rooms occupancy. Higher level of occupancy will result in more cleaning supplies used, meaning that the total variable cost will increase.

In the current COVID-19 environment, when people are more and more aware of their health, hotel customers will expect more frequent and rigorous cleaning. (Gursoy and Chi, 2020) In order to meet customers' needs and expectations, it is advisable for Harriot Hotels to increase the costs for cleaning supplies. According to Gursoy and Chi (2020), approximately 40% of hotel guests are willing to pay a higher price for increased safety measures.

Customer Discounts

Customer discounts represent 13.3% of revenue – a proportion that is relatively high. This figure means that nearly one seventh of Harriot's income is spent on discounts, which may be problematic if they want to sustain profitability during a global crisis.

In terms of cost items, 'Customer discounts' can be defined as variable cost, because it is determined by hotel occupancy levels. If the sales volume of hotel rooms is nil, no discounts would be applied, meaning that this variable cost will not be incurred.

Offering discounts could be a viable pricing strategy in the short term, resulting in an increased customer demand, higher occupancy levels and improved financial performance. (Croes and Semrad, 2012) On the other hand, reduced hotel prices may not generate enough demand to compensate for the lower prices and increase revenue. As a result, offering rooms at discounted prices is not an effective way to improve revenue in long-term. (Al-Shakhsheer *et al.* 2017) It could be recommended the senior managers at Harriot Hotels to eliminate the cost of customer discounts by setting appropriate average room rate.

Stationeries used in front desk and restaurants

Stationeries used in front desk and restaurants are 5% of Harriot Hotel's running costs, meaning that relatively low portion of the revenue is spent on stationery supplies.

This cost item can be categorized as variable in nature, since the amount of stationeries needed will increase with higher levels of hotel occupancy. Increasing the number of guests in the hotel will require more check-in forms, leaflets, pens, menus and other stationeries.

Although the percentage of total revenue spent on this cost item is relatively low, it is advisable for managers at Harriot Hotels to further decrease the costs by taking into consideration introducing online check-in, digital leaflets and menus and provide physical ones only on customer's request. (Bonfanti and Vigolo, 2021) Reducing the number of stationeries with digital alternatives will not only cut down related expenses but will also help Harriot hotels stay in line with Covid-19 health and safety regulations.

Conclusion

In the current situation of global crisis, with never ending lockdowns, new variants of the virus, restrictions on international travelling and quarantine requirements, the future of the UK hotel industry remains unclear. There are still many ambiguities concerning duration and consequences of the pandemic. The hospitality industry is supposed to be one of the last industries to recover. (Davahli *et al.* 2020) Although the process of recovery is unlikely to be easy and effortless, Harriot Hotels' senior management can take some actions to alleviate it and sustain profitability. Some of the recommendations mentioned above include reducing the number of managers and senior members by applying for one of the supports schemes offered by the UK Government; increasing spending on advertising to encourage customer awareness and improve levels of demand; eliminating costs on interest on loans by requesting an interest repayment holiday; increasing costs for cleaning supplies to meet hotel guests expectations on cleanliness and safety precautions due to Covid-19; eliminating customer discounts by setting appropriate average room rate and reducing the costs of stationeries by replacing some of them with digital alternatives.

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