

The **Operating Ratio Report (ORR)** has been designed to help associations evaluate their own performance relative to that of similar associations in order to identify improvement opportunities. The statistics in this report represent broad performance “*yardsticks*” against which an organization's performance can be measured.

Using this information, associations can compare their own organization's financial and operating performance with the industry as a whole and with associations of comparable revenue, the same membership type, the same tax status, and the same geographic scope. Spotting significant differences between your own association's performance and the industry composites can be the first step toward improving performance. Keep in mind, however, that

1. A deviation between your organization's figures (for any performance measure) and numbers in the report is not necessarily good or bad. It merely indicates that additional analysis may be required. As a rule, the larger the difference, the greater the need for further investigation.
2. In situations where large deviations do exist, it may be helpful to go back and calculate the same performance measure over the past several years to identify any trends that may exist.
3. The information in this report should be used as a tool for informed decision making rather than absolute standards. Because associations differ as to their membership type, location, size, and other factors, any two associations can be successful yet have very different experiences with regard to certain performance measures.

Understanding the Data

In order to use the information in this report to its maximum advantage, it is important to understand *how the data are arranged* and *how to interpret them*.

How the Tables Are Organized

The tables in this report are organized to include a number of important financial ratios for each relevant “grouping” of similar associations. In addition to reporting results for All Reporting Associations, the primary “grouping” used in this report is revenue size. Within each of the primary groupings there are several secondary groupings.

Primary Groupings:

- All Respondents—refers to the results of all associations responding to the survey

- Revenue Size—refers to the total revenue reported on the organization’s IRS Form 990
 - Less than \$1,000,000
 - \$1,000,001 to \$2,000,000
 - \$2,000,001 to \$5,000,000
 - \$5,000,001 to \$10,000,000
 - \$10,000,001 to \$20,000,000
 - More than \$20,000,000

Secondary Groupings:

- Membership Type
 - Primarily Company/Institutional Members (Trade Associations)
 - Primarily Individual/Professional Members (IMOs)

- IRS Tax Status
 - 501(c)(6)
 - 501(c)(3)

- Geographic Scope
 - International/National
 - Regional/State/Local

The table of contents shows specifically where each table can be found.

Interpreting the Numbers

Figures reported by responding associations were not used unless they were in accordance with the survey instructions and definitions. In cases where the number of associations reporting was considered inadequate for the computation of a meaningful figure, an “*” will appear.

Further insights into how to use this report are included in the Appendix section entitled “Ratio Definitions.” An important point to keep in mind when using this report is that *even relatively simple analysis of your association’s own financial data, using the industry data for comparison, can yield important insights into your organization. You do not have to be a financial expert to benefit from this information.*

Using Ratios

While it is extremely important to analyze financial information in dollars and cents, it is essential that percentages and ratios be used if the data are to be compared to past performance or to industry benchmarks. For example, it is necessary to know your annual employee compensation expense, but it is even more essential to compare this expenditure with the value it produces. A useful measure of **effectiveness** of compensation expense is the percentage that salary expense is of revenue. Therefore, a ratio such as salary expense as a percent of revenue can be useful in determining how efficiently your association uses its payroll dollars over time or compared to other associations in general.

In addition, just as dollar figures are not very meaningful by themselves, ratios should not be used in isolation. In combination, however, they can give an extremely accurate overall picture of **financial performance** and **financial position**. Financial performance refers to how well an association performs over a period of time (generally one year), and financial position refers to financial strength at a given point in time.

Overall Performance Ratio Analysis

The “Key Performance Ratios” included in this report provide key ratios for comparing an association’s performance to industry norms in each of five areas: profitability, productivity and efficiency, leverage, liquidity, and revenue and expense management. In using this report, it is important to prioritize time and effort by starting with the Key Performance Ratios. As discrepancies are identified between an organization’s performance measures and the industry norms, further investigation will be needed into the reasons for these discrepancies.

Profitability

One of the most basic performance measures among associations is the **net profitability ratio**. This ratio looks at the amount of revenue collected by an organization less total expenses incurred over a period of time. When association revenue exceeds expenses, it is often referred to as *surplus funds*. Conversely, a negative net profitability indicates a *deficit* for the year’s operation. The ratio is highly dependent upon revenues collected and expense control. In other words, if revenues increase or expenses decrease as a percent of revenues, net profitability will rise. The net profitability ratio should be examined with the current and quick ratio. If an organization has a low current and quick ratio, a higher net profitability ratio may be desirable.

Productivity and Efficiency

Productivity and efficiency are simply the **output produced** compared with **input expended**. As a rule, the more output produced per employee, dollar investment, or whatever the input, the more productive and efficient an association can be. Associations need to always strive to improve the productivity of their principal assets. However, in order to improve productivity, you first have to measure it.

Operating Efficiency Ratio (total revenue divided by total assets) presents a good overall indicator of **total organization** productivity. The ratio tells us how many dollars in revenues are being generated by each dollar of assets employed in running the association.

Personnel productivity can be measured in numerous ways. The easiest and most commonly used methods are:

- **Total revenue per employee**—a good overall measure, but subject to distortion by inflation. It is always best to use full-time equivalents for employees.
- **Total expenses per employee**—also a good overall measure, but also distorted by inflation.
- **Salary costs as a percent of total expenses**—complements the previous measure by adding the dimension of compensation levels instead of just the number of employees. It is not distorted by inflation.

Liquidity

Liquidity represents the short-term financial strength of the association. It is your ability to meet short-term obligations out of currently available funds. Two liquidity measures are very commonly used. Please note that these ratios are shown with and without deferred revenues within the report.

- **Current Ratio** (cash + marketable securities + accounts receivable divided by current liabilities)—this measures the extent to which fairly liquid assets (all current assets) exceed current debt.
- **Quick Ratio** (cash + marketable securities divided by current liabilities)—this ratio eliminates accounts receivable from the numerator because it is not extremely liquid, and compares the result to current debt. Therefore, the quick ratio is often considerably lower than the current ratio.

Leverage

Leverage is merely the extent to which an organization is financed by debt as opposed to existing assets. It is the amount of liabilities in relation to the total fund balance of an organization. The most significant ratio of overall organization leverage is **Total Liabilities to Total Fund Balance**. The higher this ratio is, the higher the leverage (the proportion of debt compared to fund balance).

Improving Performance Based on the Overall Performance Measures

It is very important to remember that while the key performance measures are excellent “yardsticks” for gauging the success of your organization, they must be **understood**, not just applied blindly. For instance, if the net profitability of your association is far below the industry norm, it is important to know why. Is your organization really suffering or is your profitability artificially low because you are paying high salaries? With this warning in mind, let us examine some of the key performance measures and some possible actions that can be taken if you deviate significantly from the industry average. **The following are only guidelines for action and should not be considered to be specific recommendations.**

Profitability

Net Profitability (Total Revenue minus Total Expenses)

- Too Low Further investigation is warranted. Check to see if revenues have dropped or expenses have increased. Check all expense categories to see which need better control.
- Too High It is difficult to imagine a situation where this presents a problem, but you should know why the net profitability is so high.

Productivity

Personnel Productivity

- Too Low Low personnel productivity during normal business conditions may indicate the organization is too “people heavy.” Consider decreasing staff size or generating more revenue from existing personnel.
- Too High No problem as a rule. May be artificially high if many functions are performed by outsiders not on the payroll.

Asset Productivity

Too Low A low *operating efficiency ratio* can signal a need for more attention to the productivity of the areas described above. However, if you own rather than rent your space, this could explain the deviation from typical industry figures.

Too High An *operating efficiency ratio*, which is significantly in excess of the industry norm, might be caused by the absence of owned fixed assets or the lack of any significant amount of receivables. Check your percentage balance sheet with the composite for your type of association.

Liquidity

Too Low If *current* and *quick ratios* are too low, it is possible you are operating with insufficient liquid capital. This can be dangerous if business conditions take a turn for the worse or a loan payment becomes due unexpectedly. Liquidity can be increased by using more long-term financing and/or by increasing the net profitability of your organization.

Too High If liquidity is exceptionally high, it is possibly a sign of excess receivables. Check productivity ratios for these items. Otherwise, this is no reason for concern.

Leverage

Too Low You have excess capacity for debt should it become necessary to borrow. Although some organizations do not like borrowing any more than absolutely necessary, additional debt can grow your association as long as the organization can earn a return that exceeds its borrowing rate.

Too High This will severely curtail your ability to attract new borrowed funds. In addition, interest charges could be severely affecting cash flow. Try increasing net profitability or attracting new sources of equity if you wish to lower leverage.

Summary and Conclusion

We believe the information contained in the **Operating Ratio Report** is one of the most comprehensive compilations of association industry performance statistics in existence. While the quantity of information may, at first, seem overwhelming, by following the approach outlined in the preceding pages, your time and efforts can be channeled into a very effective and beneficial analysis. To summarize:

Step 1

Gather all your financial and operating results for your latest fiscal year. If you participated in the latest survey, this has probably already been done.

Step 2

Calculate the various performance measures for your organization that are used in the report. Start with the “Key Performance Measures.” (If you participated in the survey, provided a 990 form, and filled the survey form out completely, most of the calculations have already been made for you.) It is important that you use the same line items as outlined in the “Ratio Calculations” section beginning on page 235 so that the data you use to determine the ratios will be comparable to those in the report.

Step 3

Determine which data comparison in this report is most comparable to your organization.

Step 4

Using the analytical guidelines for the key ratios discussed above, analyze your organization’s strengths and weaknesses.