Transferable memberships – They are not a funding panacea

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We have been promising our views towards transferable memberships (TM) for quite a while now and are pleased to finally put them in print. The topic has had some coverage lately, with Golf Digest having a go at it and more recently some interesting comments were made in The Golfer Newspaper. We will make comment on what was said and then look at the transferable membership concept, determining who can potentially use it.

In The Golfer a high ranking state official was quoted as saying that "over time, all clubs will move towards a TM arrangement." Another suggestion made in the same article (and headline) called for joining fees to scrapped and that the funding of capital expenditure via joining fees is a "dangerous (funding) model."

Two issues arise from these comments, being how to fund capital requirements and club operating profitability. Firstly, to say "all clubs" should scrap joining fees is a bit of a stretch as the present reality is that only 60% of clubs receive them and for many they aren't a large income source (just over half average less than $200). The actual worrying statistic is that only 12% of these clubs (as measured in the 2004 Industry Report) are setting aside these joining fees for capital purposes with the remaining 88% taking them into trading revenues.

We'd therefore conclude that this practice is the actually the dangerous one as operating profitability will be immediately impacted should new member demand dry up. (With a 6% fall in membership around the country since 2000 many are already experiencing declining demand.)

The second issue is operating profitability. As the golf club industry has been trained to operate with a not for profit mentality, with clubs existing "for the members" there is a seemingly inbuilt member desire to not generate too much profit each year. We have lost count how many times we have heard the "if you can make that much profit then you can lower my fees" statement. Given this mentality, the allocation of joining fees directly into the capital account, and not showing them in the trading summary has been the only way to actually make money without the above complaint (though only 7% of all clubs (12% of 60%) are actually doing this!).

The article in The Golfer stopped short of stating what would be required if in fact joining fees were scrapped. What is it? Naturally, it is increased club operating profits. If no joining fee income was available, then there is simply no other choice but for capital to be sourced from operating profit. Profit would therefore need to be seen in a positive light, with members understanding that this profit will be used to improve their asset. The desire for cheaper fees will only ensure that the asset is maintained "as is" (at best), and the club will fight and eventually loss the battle against ageing infrastructure.

Given the joining fee reality outlined above, it has been suggested that transferable memberships are the answer. Get the member to pay a fee premium (for the ability to transfer the membership at a later date) and your capital needs are suddenly met. Let us state our position on this: TRANSFERABLE MEMBERSHIPS ARE NOT A CURE FOR EVERYONE. They will only work in certain circumstances.

Why not?

The report written by E&Y for the VGA titled "Issues and Challenges for Golf Clubs in Victoria" contained a section on TM's. For those who haven't read it, the section outlined the typical features of a TM, general strengths and weaknesses, and it referenced a real life example in Portsea Golf Club, being a club that had (at the time) recently introduced a TM scheme.

To understand why TM's aren't a capital fund panacea and why most should never even consider moving in that direction it is necessary to understand the evolution of the TM.

We paraphrase from our report: "The membership model that offers membership transferability is mainly concerned with new golf developments. In present times, as baby boomers focus on income generation and capital protection, traditional joining fees are often perceived as "dead money."

The fact that the joining fee will never be refundable is also no doubt a hurdle to entry to a golf club that some potential members will not accept. The "modern" membership was therefore born when this issue was removed by attaching transferability. A joining fee that could be re-couped on transfer to another party effectively ended the perception that club joining fees were still wasted money. By attaching transferability, the price to be paid could also be increased, thereby also increasing the capital pool to a level that met development costs of the new club."

We have seen the TM concept adapted by some existing clubs (mainly Melbourne based), primarily as a way to raise capital for necessary infrastructure projects. Varying levels of success are evident with sales mainly made to existing members though in many cases we believe that the price points have been too high. We won't get into that issue today; suffice to say that to those who are looking at adapting the TM concept should do so with a lot of caution.

The underlying requirement for TM's is demand. This is why TM's will never work in the majority of markets around Australia – there is simply not enough of it. Think about it – for a TM to sell at $X price, there is an assumption being made by the buyer that one day it will be saleable, and this will be reasonably easy. What if you can't? Let's look at the conditions that typically exist. Firstly, you are often required to hold the membership for a certain time period with sale not allowed. A condition often prevalent in the typical TM model used requires full annual fee responsibility regardless of whether you even play - there is no reduced fee, non-playing category.

So now what are the options? After the no sale period has expired, you can most often seek to lease the membership (requires new demand) but you are still 100% responsible for the annual fee payment. Can you drop the price? Another condition sometimes present requires sale back to the club with the secondary sale memberships sold on a 2 for 1 or 3 for 1 basis. If your sale price is much lower than the clubs price, you certainly won't have priority as the sale will devalue all of the remaining unsold stock.

These conditions all sound quite harsh but you must understand why they are there in the first place. The formative years of a club are the most crucial and the membership conditions are required to give the club a chance to build some cashflow, improve its amenities and attract more members. If members were able to come and go without restriction the chances of failure would certainly be heightened. (Depending on the market mood, these conditions can also be a poison chalice. If the conditions are too tight then memberships won't sell in the first place. A few of the newer developments have been caught in this trap as it is a currently a buyers market, the buyer can afford to wait. The new club/developer often can't.) With all of the above in mind you can certainly see why demand, and plenty of it, is typically needed.

Another issue concerning demand is that TM's will typically only work at higher price points. We tested this opinion in our recent consumer research, first asking what type of membership (transferable or non-transferable) would be preferred. We found that 75% are in favour the current traditional (non-transferable) model, no change to the result in 2003. The TM model however does find favour with 50% of golfers whose annual fees exceed $2k.

Conclusion: A large majority aren't even interested in the TM concept.

We then asked how much extra they'd be willing to pay over the traditional joining fee. We found that 75% of consumers would only pay up to 2 times. (When analysed by the annual fee currently paid, of those currently paying less than $1k, this increased to 85%.)

Conclusion: For the market to be receptive to any significantly sized TM fee (say >$10k – remember the aim is to raise a decent amount of funds and there is not unlimited room for members), the product is going to have to be very, very good.

The simple reality is that the market for a TM product is very small and it will only work in certain circumstances.

What are these circumstances?

We have already talked about demand in that it needs to exist in sizeable numbers (primary and then secondary). We'd suggest this will only be available within or very close to a major metropolitan market that provides a large potential demand base. This immediately removes almost all regional candidates. Next, the TM price needs to be meaningful. Anything below the acceptable "dead money" zone will not see any sizeable capital fund created (the goal) and demand will likely dictate that an alternative to the TM will have to be available anyway. You might be thinking – at what point does the acceptable "dead money" line and the "amount you'd actually like to see back (some day)" line cross?

There is one real example which we can refer to that gives some guidance as to where this point might be. The Sandhurst Club in Melbourne, opened in June 2004, was essentially offering two types of memberships in their early prospectuses. Type A was the transferable version priced at $16k and Type B, the non-transferable/refundable version, priced at $8k. We are reliably informed that sales to date of the Type B memberships have accounted for less than 3% of all sales.

This example supports the 2 times ratio offered up by the consumer and illustrates that at some point "dead money" does become too much if there is an alternative option. We have no statistics to prove it but our guess for the majority is it is anything north of the $5k mark (though 3% at Sandhurst have spent $8k). This price point immediately removes 90% of the 60% of clubs that have a joining fee. (The 2004 Industry Report found that of the 60% of clubs with a joining fee, only 10% charge over $5,000.)

Should the membership options move too far away from the 2 times price multiple and get nearer to 3, one of two things could happened. The "dead money" line could shift (keep an eye on the competitors traditional pricing) or no memberships at all will be sold as both prices take the consumer out of their comfort zone – too much "dead money" and too much other opportunity cost, particularly if the perceived quality doesn't keep moving in a positive direction.

This leads to the final point. The TM product has to be worth the money. Those that have chosen the TM path to date have courses that are or will likely be ranked in at least the Top 50 in Australia. Cross tabulating data from the 2004 Industry Survey and the Top 50 (traditional membership) courses as ranked by Golf Digest indicates an average joining fee of $6,500 and annual fee of $2,200. These price points suggest a quality product and that there is value for money to be found.

Despite all of the above (making sense to us) we still get asked the question "but what about the National?" Agreed, it breaks a lot of the above rules. Location – just close enough (now) to a major metropolitan centre but in the early days a good 1.5 hour trip. Price - the early single member TM price pre-opening was $5k, (just on the "dead money" cusp). An experience worth the money: this is where it kicks goals from the 50m line. Built on outstanding terrain, it offered a golf experience not previously available in Australia. The market: there is no doubt that the club also benefited from the market conditions at the time, where there was limited accessibility to top quality golf in the Melbourne metropolitan area.

Despite these favourable conditions and the experience offered, few people actually know that the club, as successful as it is today, very nearly didn't make it. If it was not for the vision, commitment and patience of a few it would have been a failed dream. Its ultimate success however does make others dream, though it is likely a one time dream that will never again come true.

There are a myriad of other issues around TM's which we won't go into today - administration costs, 3rd party sale, their status in liquidation, and the need for the club to generate operating profit to feed future capital needs. When you combine all of the required elements mentioned in this article it is our view that there are perhaps only 20 to 30 clubs in Australia that could successfully roll out the TM concept, a far cry from the "all clubs" opportunity suggested by some. We do hope, that given the issues discussed in this article, you will therefore concur with us when we say that TM's are not for everyone and they are certainly not the potential panacea to the capital funding challenge that many clubs are currently facing.