

A financial case study of sovereign lodge

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The Sovereign Lodge is old, but well-maintained belongings that have changed ownership several times over the old ages. It has no eating house or saloon. It is positioned as a mid-price, good quality "finish" resort Lodge. The Sovereign Lodge is unfastened during the skiing season. It opens on December 2 and closes the last twenty-four hours of March. The ski mountain it serves operates on a license from the province which allows merely 120 years of operation per twelvemonth. Each of the 50 suites in the east wing rents for \$ 15 for individual tenancy or \$ 20 for dual tenancy. The west wing of the Lodge has 30 suites, all of which have dramatic positions of the skiing inclines, the mountains, and the small town. Board in this wing rent for \$ 20 and \$ 25 for individual or dual tenancy, severally. The mean tenancy rate during the season is approximately 80 % (typically, the Lodge is full-on weekends and norms 50 to 60 suites occupied on hebdomad darks.) The ratio of individual versus dual tenancy is 2: 8, on the norm.

Operating consequences for the last financial twelvemonth are shown in Exhibit 1. Mr. Kacheck, the director of the Lodge, is concerned about the off-season months, which show losings each month and cut down the high net incomes reported during the season. He has suggested to the proprietors, who acquired the Lodge merely at the terminal of the 2006 season, that to cut down the off-season losing, they should hold to maintain the west wing of the Lodge running year-round. He estimates the mean tenancy rate for the off-season to be between 20 % and 40 % for the following few old ages. Kacheck estimations that with careful attending to the off-season patronage a 40 % tenancy rate for the 30 suites during the off-season would be much more likely if the proprietors would perpetrate \$ 4, 000

for advertisement each twelve month (\$ 500 for each of 8 months). There are no grounds to bespeak that the 2: 8 ratio of individual vs. doubles would be different during the balance of the twelve month or in the hereafter. Rates, nevertheless, would hold to be drastically reduced. Present programs are to cut down them to \$ 10 and \$ 15 for singles and doubles.

The director's wage is paid over 12 months. He acts as a caretaker of the installations during the offseason and besides contracts most of the fix and care work during that clip. Using the west wing would non interfere with this work, but would do an estimated extra \$ 2, 000 per twelve month for fix and care. Mrs. Kacheck is paid \$ 20 twenty-four hours for oversing the amahs and assisting with check-in. During the season, she works 7 years a hebdomad. The regular desk clerk and each amah are paid on a day-to-day footing at the rate of \$ 24 and \$ 15 severally. The paysheet revenue enhancements and other periphery benefits are about 20 % of the paysheet. Although depreciation and belongings revenue enhancements would non be affected by the determination to maintain the West flying unfastened, insurance would increase by \$ 500 for the twelve month. During the off-season, it is estimated that Mr. and Mrs. Kacheck could manage the forepart desk without an extra individual. Mrs. Kacheck would, nevertheless, be paid for 5 years a hebdomad.

The cleaning supplies and half of the assorted disbursals (room supplies) are considered a direct map of the figure of suites occupied. The other half of the assorted disbursals are fixed and would non alter with a 12-month operation. Linen is rented from a supply house and the cost besides depends on the figure of suites occupied, but is twice every bit much, on the norm, for <https://assignbuster.com/a-financial-case-study-of-sovereign-lodge/>

dual tenancy as for individual tenancy. Public-service corporations include two points: telephone and electricity. There is no electricity disbursement with the Lodge closed. With the Lodge operating, electricity disbursement is a map of the figure of suites available to the populace. Rooms must either be heated or air-conditioned. The telephone measures for each of the four seasonal months were as follows: 80 Telephones \$ 3. 00/month \$ 240, Telephone Basic Service Charge 50 \$ 29.

During the off-season, merely the basic service charge is paid. The monthly charge of \$ 3 is applicable merely too active telephones. An extra facet of Mr. Kacheck 's proposal is that a covered and hetswimmingpool be added to the Lodge. Mr. Kacheck believes that this would increase the chance that the off-season tenancy rate would be above 30 %. Precise estimations are impossible. It is felt that although the winter tenancy rate will non be greatly affected by adding an indoor pool, finally such a pool will hold to be built to remain even with the competition. The cost of such a pool is estimated to be \$ 40, 000. This sum could be depreciated over 5 old ages with no salvage value (\$ 15, 000 of the \$ 40, 000 is for a plastic bubble and the heating units, which would be used nine months of the twelvemonth). The lone other costs associated with the swimming pool are \$ 400 per month for a lifesaver, required by jurisprudence during the busy hours, extra insurance and revenue enhancements, estimated to be \$ 1, 200; heating cost of \$ 1, 000; and an annual care cost of \$ 1, 800. If the pool were covered, a guard would be needed for 12 months. If it is non covered, a guard would be needed merely for 3 summer months (from 15 June to 15 September, the warmest period of the twelvemonth), and there would be no warming disbursement.

Exhibit 1 Sovereign Lodge**The Options are:**

- Stay unfastened, no advertisement, and no pool.
- Stay unfastened, advertisement, no pool.
- Stay unfastened, no advertisement, and pool merely.
- Stay unfastened, advertisement, and pool merely.
- Stay unfastened, no advertisement, pool and bubble.
- Stay unfastened, advertisement, pool, and bubble.

A matrix demoing incremental fixed costs for each of the six options and classes of cost-covering, fixes, insurance, Mrs. K, advertisement, the pool, the bubble, pool disbursements (rather a few classes here), telephone, electricity, and amahs (if you think necessary) . Each figure in this matrix should be carefully explained as if to a non-finance individual.

Fixed costs for the offseason which is besides known as Incremental fixed cost:

Manager's married woman: she is paid merely 5 years a hebdomad hence, the figure of years for which she is paid

- Entire years in the 8 month period = $(365-120) = 245$ years
- Therefore, the figure of hebdomads in that period $245/7 = 35$ hebdomads
- 35 ten 5 years = 175 years (Mrs. Kacheck is paid merely for 5 years a hebdomad)
- 175 ten \$ 20 = \$ 3500 (sum spent on Mrs. Kacheck 's wage)

Maid's wage

At least one amah is considered in the off extremum season and the options in which advertisement is done 2 amahs are taken.

- Maid is paid \$ 15 per twenty-four-hour for 245 years during the off extremum season
- $15 \times 245 = \$ 3675$ per amah
- Sing 1 amah for 8 months consequences in the \$ 3675
- While for 2 amahs, $2 \times \$ 3675 = \$ 7350$

Repair and care

\$ 2000 for 8 months (mentioned in the instance survey)⁶ Additional \$ 1800 for the options in which the pool is considered.

Utilities: (Telephone + Electricity)

Utilities expense = telephone + electricity + warming (in alternate 5 and 6 merely)

- The telephone and the electricity is the direct map of the figure of suites available to the populace it is considered for 30 suites.
Telephone for 1 month 290.
- Therefore telephone for 4 months = $290 \times 4 = 1160 + 400$ (basic service charge for 8 months when all the line were closed assuming that the Lodge was closed for 8 months) = \$ 1560
- Expenses on telephone for 8 months presuming that the 30 suites are available to the public = $30 \times 3 = 90 + 50$ (basic service charge for east wing which is closed) = \$ 140 per month

- Therefore, for 8 months = $140 \times 8 = \$ 1120$

Electricity

- Hence by here we can cipher the electricity disbursal i. e. = $6360 - 1560 = \$ 4800$
- Electricity disbursal for 80 suites for 120 yearsss = 4800
- Therefore electricity disbursal of per room per twenty-four hours = $4800 / (80 \times 120) = 0.5$ per room per twenty-four hours
- Therefore for 30 suites for 245 yearsss = $0.5 \times 30 \times 245 = \$ 3675$
- And heating disbursal will be \$ 1000 (wherever pool and bubble is included i. e. in alternate 5 and 6)
- Then calculate the incremental part (in \$) per occupied room/day during the off-season?

Incremental Contribution = Revenue - Variable disbursal

Incremental Variable disbursals

Linen services:

- For disbursals of 4 months = 13920 (given in the instance survey)
- Concerning 80 % of 80 suites presuming the ratio of Single: dual as 2: 8
- Therefore linen supplies = $13920 / (13 \text{ individual suites} \times 1 + 51 \text{ double suites} \times 2) = 13920 / 115 = 121.05$ for 4 months

Therefore linen disbursal for 1 twenty-four hours $121.05 / 120 = 1.01$

Therefore in 245 years, we have 6 suites occupied in the ratio of 2: 8 as an individual: dual (4 double suites cost \$ 8 and 2 individual suites cost \$ 2 per

twenty-four hours giving a sum of \$ 10 per twenty-four hours for the linen services) $245 \times 10 = \$ 2450$. Similarly when the tenancy rate is dual i. e. 40 % at that clip the figure of suites alterations from 6 to 12 and sings 3 singles and 9 dual suites the linen comes \$ 5145.

Cleaning supplies

- Expenses on cleaning supplies in 4 months = 1920
- No. of suites occupied in that period = 80 % of 80 = 64 suites

Therefore, cleaning supplies per room per twenty-four hours = $(1920) / (64 \times 120) = \$ 0.25$

- Hence, for 6 suites for 245 yearss = $0.25 \times 6 \times 245 = \$ 368$
- Similarly, when the figure of suites taken is 9 for the instance of 30 % and for 12 for 40 % tenancy.
- Hence, for 9 suites for 245 yearss = $0.25 \times 9 \times 245 = \$ 551$
- Hence, for 12 suites for 245 yearss = $0.25 \times 12 \times 245 = \$ 735$

Assorted disbursal

- 50 % of 7314 is variable i. e. 3657 for 120 yearss sing 64 suites
- Therefore misc. disbursal per room per twenty-four hours = $3657 / (64 \times 120) = 0.48$ per room per twenty-four hours
- Hence for 6 suites for 245 yearss = $0.48 \times 6 \times 245 = \$ 706$
- Similarly, when the tenancy rate is 30 % the figure for suites taken is 9 and when it is 40 % the figure for suites taken is 12.
- Hence for 6 suites for 245 yearss = $0.48 \times 9 \times 245 = \$ 1058$
- Hence for 6 suites for 245 yearss = $0.48 \times 12 \times 245 = \$ 1411$

By splitting each of the six incremental fixed costs by the incremental part per unit, and comparing this figure with the figure of room/days available outside of the skiing season, you should deduce interrupt even tenancy per centum in the scope 18 % - 44 %. For each determination, alternate calculate the tenancy rate necessary to interrupt even on the incremental one-year disbursements.

Break even volume = Incremental fixed cost / part border per unit (room)

The tenancy per centum comes out to be about equal to 40 % since all the options i. e. remain unfastened, advertisement, pool, and bubble. The figure of suites required to be filled is about equal to 12 out of 30. By comparing these breakeven figures with Mr. Kachek 's outlooks (as indicated in the text) you should pull decisions about which of the options is the best.

The recommended option on the footing of breakeven computations:

Ans. The best option should be the first one i. e. merely to remain open because merely 5.5 % more tenancy is needed to run into the interruption even status which is rather less every bit compared to the other values. This determination option can besides be considered because of the gross. Mr. Kacheck besides thinks that if the advertisement is done so the tenancy per centum will be at least 40 % and by comparing the per centum of the part border to the incremental fixed cost gives the Break-even volume which is good for the first option.

Alternate 1: The breakeven volume the rate of per centum which is required to be increased in the tenancy comes to be 5.09 %. All the computations are

done using the tenancy rate as 20 % in that determination option. To run into a status where the entire gross is equal to the entire disbursement the most favorable rate of tenancy for this instance should be 14.01 %

Alternate 2: The breakeven volume the rate of per centum which is required to be increased in the tenancy comes to be 7.8 %. All the computations are done using the tenancy rate as 40 % in that determination option. To run into a status where the entire gross is equal to the entire disbursement the most favorable rate of tenancy for this instance should be 42.2 %

Alternate 3: The breakeven volume the rate of per centum which is required to be increased in the tenancy comes to be 9.68 %. All the computations are done using the tenancy rate as 30 % in that determination option. To run into a status where the entire gross is equal to the entire disbursement the most favorable rate of tenancy for this instance should be 21.4 %

Alternate 4: The breakeven volume the rate of per centum which is required to be increased in the tenancy comes to be 12.4 %. All the computations are done using the tenancy rate as 40 % in that determination option. To run into a status where the entire gross is equal to the entire disbursement the most favorable rate of tenancy for this instance should be 27.6 %

Alternate 5: The breakeven volume the rate of per centum which is required to be increased in the tenancy comes to be 11.10 %. All the computations are done using the tenancy rate as 30 % in that determination option. To run into a status where the entire gross is equal to the entire disbursement the most favorable rate of tenancy for this instance should be 19.9 %

Alternate 6: The breakeven volume the rate of per centum which is required to be increased in the tenancy comes to be 13.8%. All the computations are done using the tenancy rate as 40% in that determination option. To run into a status where the entire gross is equal to the entire disbursement the most favorable rate of tenancy for this instance should be 26.2%

7A Using the original net income statement for the skiing season, and the best option for the nonskiing season you should deduce an overall annual net income figure for Sovereign Lodge. After analyzing the income statement of the extremum season i. e. skiing season along with all the six options, the 2nd option is the best 1 in which the Lodge stay opens along with the advertisement.

Note: In this option, the net income comes to be highest which is the ground to choose this option in order to transport forward the Lodge to remain unfastened for the remainder of the off extremum season. You should compose a decision which incorporates your remarks in Note 5, and your sentiment from Note 6, and any other positions about the hereafter of this Lodge in order to do a concluding recommendation to the owners. This decision should be at least half a page long.

Ans. The fiscal statements say that 2nd option in which the Lodge is to remain unfastened with the advertisement but no pool is the best option because the net income for that option is the highest and to be more profitable is the best thing. As Mr. Kacheck's outlook, if the advertisement is done maintaining the Lodge unfastened, the false per centum is 40 which enables the overall gross for the twelvemonth to be the highest. The net

income for this determination option is highest amongst all i. e. \$ 16819. Because there are no extra disbursements the overall gross is high and there are more net income borders. Mr. Kacheck expects that the net income border will be higher for the options in which the advertisement is done. Initially, the basic status is to maintain the Lodge unfastened during the off extremum season, and in that period if no extra disbursement is done so the net income comes to be the higher as in the 2nd option. The ad can better the tenancy per centum as more people will come to cognize about the Lodge. The advertisement money can be utilized in the web site of the Lodge so that people can happen out the information about the Lodge online.