Hotel repositioning

Finance, Investment

{draw: frame} University of Derby/Buxton Hospitality Management MA Hotel Renovation A Tool For Repositioning In the Hotel Industry Submission Date: 7th May 2009 Business Analysis and Decision Making Student: Nana Yaa Addo Module Leader: Norman Dindsdale Introduction The hospitality industry has grown phenomenally since 2001 and has been driven by both leisure and business demand (kloppers 2005). The needs of the consumer have now become dynamic rather than static.

Consumers today have a strong desire for luxury in every sense of the word be it travel, goods or even a night stay in a hotel, thereby creating a competitiveenvironmentamong business owners and organisations to come up with innovative ways to increase and also retain their business. Altstiel and Grow (2005 p. 28) similarly states that " people do not buy things but rather a satisfaction of their wants and needs. Therefore the hospitality industry being a service sector is not an exception as the industry must also meet challenges by formulating and implementing strategies that will meet today's economic conditions and also satisfy customer needs. This report focuses on how hotel renovation can be used as a tool for repositioning in hotel operations. It will explore the theory behind repositioning and test the theory by looking at some case studies within the industry, it will also try to identify its challenges and successes and see how it could be undertaken in the future. Main body

The term repositioning has been used side by side with positioning, branding or new product development and has a wide range of definition, as a result it has no exclusive accepted definition. For example, the work of Hassien and Baum (2002p146) give the following definitions of the term which perceives

a greater understanding. (Lovelock, 1996; Lewis et al; 1995) define the term as the changing of the existing position without referring to its implementation (Hart and Stapleton, 1987; Collin, 1989; Jefkins, 1987; Ries and Trout, 1986) define it as an advertising trategy by which the company can change the image of its product and the perception of people about it. Booz, Allen and Hamilton (1982) define the term as one of the six categories of new products in terms of their newness to the company and to the marketplace, as being the process of targeting the existing products to new markets or market segment. In addition the business dictionary also defines it as changing a brands status in comparison to that of the competing brands.

Furthermore Hassien and Baum go on to say that “ an in-depth review of its literature identifies that there is a general agreement in most of these definitions, that repositioning involves a change to the image of a product in the market through changing the perception of the customer”(p. 146) and finally define the term as “ the marketing management process of changing, partially or totally, the perception of the public about a firm through any modification or addition to one or more of its controllable variables (eg.

Customer, competition, technology, coporate, etc.) in order to retain, expand or change its target markets”(p. 147) From the above definitions it is obvious that repositioning involves the modification of a product to make it more appealing in order to attract existing customers or new market segments The Concept Of Repositioning. Due to intensifying global competition, a constantly changing environment, current consumer trends

and modern technology, repositioning like any other marketing tool adopts a strategy in order to be successful.

For instance Macmillan (2000, p45) states that ‘ conditions in the global business environment demands that established firms adopt entrepreneurial strategies’. Johnson and Scholes(2002 p10) have defined strategy as “ the direction and scope of an organisation over the long term which achieves advantage for the organisation through its configuration of resources within a changing environment and to fulfil stakeholder expectations. ” Bowie and Butler (2004 p. 06) state the following reasons as to why a company may be forced to reposition; Falling sales (often a symptom of customer dissatisfaction) An opportunity to service an emerging market segment The threat of competing for market share. As a result Jobber in the book of Enew and Waite (2007 p. 165), identifies four basic repositioning strategies and they are listed as follows Image repositioning- This means keeping the product and target market the same but changing the image of the product.

Product repositioning –This means that the product has been modified to meet more fully the expectations of the target group. Intangible repositioning-An organisation targets a new market segment with existing products but places the emphasis on a different , less tangible aspect of the product. Tangible repositioning-In some market sectors there is the need to change both product and target market moving upmarket or downmarket through the introduction of a new range of products often demands a comprehensive repositioning strategy.

Similarly a study by Kotler et al 1993 cited in Crompton 2000 pp70-72) offers three strategies that can also be used to achieve repositioning and they are as follows; Real repositiong: which means that an agency changes what it does so that desired community priority needs are met through its offerings Competitive repositioning which means altering stakeholders’ beliefs about what an agency’s competitors do. Psychogical repositioning which means altering stakeholders beliefs about what an agency currently does From the above, it can be deduced that;

Repositioning is used to alter perceptions of the consumer It is used by organisations to ensure they exceed the expectations of the consumer in order to retain themselves in the business environment It is used to identify growth and opportunities. It must however be noted that whatever strategy that is employed , must be realistic, achievable, results focused and must also take into account which strategy best fits the needs of the business as well as that of the consumer.

However for the purpose of this report the attention is on renovation as a tool for repositioning in the hotel industry in other words the focus is on the use of renovation to develop or improve existing and new product lines. Renovation Definition According to Hassien and Baum (2001p. 148), renovation may be defined as “ the process of retaining or improving the hotel image by modifying the tangible product, due to a variety of reasons, through any changes in the hotel layout (e. g. Property structure-new extension) and/or any additions or replacement of materials and furniture, fixture and equipment”.

It may also be defined as “ a facility for which a substantial amount of the equipment, structure or other components is replaced or modified and which may expand capacity and/improve the process of the facility” (CII 2006, P1) From the above it can be noted that renovation as a process involves a lot of activity which can either be upgrading of the design, decor etc of the property layout or the development of an entirely new product. Types of renovation Renovations may be classed as major or minor depending on the amount of work involved in each type.

For instance a renovation that involves the renewal or replacement of all equipment, furnishings and finishes in order to improve or change the image of the physical layout of the hotel may be termed as a major renovation, whiles a renovation that involves the upgrading or replacement of soft goods such as carpets, drapes, beddings etc without changing the physical layout of the property. The property must be in a market not sustaining the desired level of operation There must be an alternate market not being served Change in the market they serve

Furthermore Hassien and Baum (2002p. 148) cite these reasons; To keep up with the competition To maintain or increase market share by satisfying current or potential customers To improve the operational efficiency of the hotel that will lead to an increase in both productivity and long term savings in operational expenses To maintain corporate image and standards To upgrade the hotel to a higher category (eg. From 4 to 5) To comply with the new trends and technology in the market The process of renovation while its clear a renovation or brand conversion is intended as an improvement on

your investment, managing a long list of decisions will make for a shortfall in revenue without the right plan in place”(sansone et al 2009 p. 20). It must be noted that renovation is constantly an ongoing process in hotels and it employs certain decision making factors to ensure its success. These decisions if undermined can cost hoteliers a great deal ofmoneyand if taken seriously can reap rewards in other words renovation can either pose a financial challenge if not planned well or reflect profitability if planned well.

There is nothing worse than being in a hotel when these processes are on going, the noise, the uncertainty and the feeling that you are experiencing ‘ second best’. The following decisions have been identified through research that renovation undergoes the following processes. Planning In the planning process, elements such as team, budget, timing and marketing are taken into consideration. Team: It has been argued that the very first step when the decision on renovation has been taken is the selection of a team usually comprising experts and project managers. Rowe and Megan1995, Hassien and Baum 2002). These people are usually charged with theresponsibilityof providing expertise in the accomplishment of budgets, contingencies and scheduling from the start till finish of the project and can be a complete waste of time and money if they are not involved in the renovation project(Sansone et al 2009). Budget: This usually involves taking into consideration a realistic amount of money that is believed to be enough tofinancethe project. It is also the most important and critical aspect pertaining to the project.

It is usually based on criteria such as the time value of money, wealth maximisation and risk accommodation. Timing: Recognising when to undertake a renovation is also very important in the decision making process. This is because hoteliers must carry out such projects when occupancy is low so that renovation can be carried out with less disruptions and minimise risk in terms of safety Bowe and Megan 1995) It is also interesting to note that there aside the above decisions taken during the renovation process, key areas of long term decision making is that of investment.

The decision to carry out these important changes must, of course, involve a much more complex set of criteria. The key concept of finance being the first that is reviewed and factored in terms of risk. It is assumed that the objective of any financial investment is to maximise economic benefits. Hence “ projects which pass through the preliminary screening phase become candidates for rigorous financial appraisal to ascertain if they would add value to the firm (Dayananda et al 2002 p. 7).

Four investment appraisal techniques namely, ARR(average rate of return, Payback, NPV(Net present value)and IRR(Internal rate of return)are usually considered in the decision making process in large companies with Payback and NPV proving to be the most popular(Lamminmaki et al cited in Guilding 2005 p. 205) To touch briefly on the above; ARR- measures the incremental operating income that will be generated per dollar of investment in other words it measures profitability by comparing the required investment to future annual earnings(Oliver& Amacom 1999p. 11, Dayananda et al 2002

p43) Payback-It attempts to forecast how long it will take for the expected net cash inflows to payback the investment outlays (Glautier and Underdown 2001 p. 448) NPV- The excess of the present value (PV) of cash inflows generated by the project over the amount of the initial investment (Shim&Siegel 2007 p. 209) IRR- It represents the true interest rate earned on an investment over the course of its economic life (Colin Drury 2004 p. 501. For the following theNPV and IRRare used as being the most important in the individual case studies.

This does not mean the others would not work, simply these were the most appropriate. Informed assumptions are made within the case studies as only outline information was available from the companiesCase study1 January 18-24, 2004 Crown Plaza Owners of the hotel invested 7 million dollars to renovate the crown plaza in Philadelphia to restore the hotels reputation which owners believed have suffered as a place for corporate meetings and stays as well as well as to target the SMERF market(social, military, educational, religious, fraternal bookings).

Hotel owners updated rooms , with a redone lobby, restaurant, common areas and meeting rooms. The hotel is located on city avenue and is a walking distance from the new target store, that brought with it a host of smaller retailers including chipotle grill, sandwich works and California pizza. “ I’m not sure how it affects business, but guests like to walk to a restaurant which is definitely a convenience for guests”. Calculating IRR IRR= A+(Na/Na-Nb)*(B-A) Where A = Lower DF (10%), B = Higher DF (20%), Na= NPV at 10% Nb= NPV at 20%. Therefore; IRR= 10+ (0. 662/0. 662-1. 02) *

(20-10) IRR= 10+ (-O. 2) *(10) IRR= 9. 98 Case study 2 The Grand Hyatt (New York) July 15, 2004 To reaffirm the brand as a leader in the multi purpose hotels, the Grand Hyatt under took a 55million dollar renovation project. The project touched every area of the hotel with more emphasis on guest room and meeting spaces. The guest rooms were designed to give them a more international look with design elements including a colour palette of golds and taupe with blue accents. Roman shades dug in into the window wells to replace traditional draperies, an all new cabling and wired smoke detection and emergencycommunicationsystem.

Work and play amenities include a 27- inch flat screen T. V, a standard workstation with ergonomic chair, CD- clock radio. Bathrooms were upgraded with porcelain tiles, black granite pedestal sinks, stone flooring and curved shower rods. An entire floor was upgraded into a high tech conference centre targeting financial companies that needed the latest technology as well as privacy to do their business. Therefore calculating the NPV for case study 1 is illustrated below In evaluating both studies it is obvious that the main reasons for undertaking these renovation projects was to: Compete against other hotels

Satisfy their customers Increase profitability by attracting customers. The basic rule underlying NPV is that if the present value of the returns exceed the present value of costs then the project should go ahead since it will increase profits. (Atkinson and Miller p. 315). In other words the project should be carried out if the NPV is positive. In case study 1 an initial investment of 7million dollars in year 0 is assumed to give rise to inflows of

2million dollars for each of years 1 to 5 So in this case an NPV of 0. 662 and 1. 02 respectively are both positive figures and hence the project will be profitable.

However this same projects could be risky because of it's IRR. For instance Finnerty(2005 p. 157) is of the view that ifthe IRR exceeds the project's cost of capital then the projects should be undertaken but in this case an IRR of 9. 98 is less than both the lower and higher discount factors of 10% and 20% respectively and therefore will be in the interest of decision makers to forgo the project. In case study 2 an initial investment of 55million dollars in year 0 is assumed to give rise to inflows of 12million dollars for each of years 1 to 5. In this case an NPV of 9. 52 also indicates a positive figure hence a profitable project.

This suggest that higher is better for both NPV and IRR in other words investments with higher rates of return are more profitable than investments with lower rates of return but it can be argued that " since the economic environment is dynamic the cost of capital can be influenced by such changes,(Watson &Head 2007) rather it will be better if business owners sought to maximise shareholders wealth through considering their investment value in monetary terms rather than focusing so much on it's immediate return. Moreover both the NPV and IRR have its merits as well as its demerits. Atkinson and Miller(1998 p. 18)give the following merits for the NPV; Gives a clear quantitative result Emphasises the time value of money and makes it superior to methods which do not involve discounting. Involves maximisation of present values of future cash flows thereby maximising

shareholder wealth. Despite its merits , Siddiqui (2005 p. 325, Rashid, Raj & Walters 2008p. 194) of the view that ; It is not helpful in comparing two projects with different cash flows It may be misleading in comparing projects of unequal lives It is complicated to estimate the values of cash inflows and outflows over the life of a project.

Alternatively, (Capon& Disbury 2004 p. 224) state that the IRR has the following merits; It results in a clear percentage return required on investment since emphasis is placed on liquidity in calculation. It's the measure of the intensity of capital use and also gives a return for risks Takes into consideration the time value of money and deals with discount cash flows. Several authors strongly oppose and cite reasons as to why the IRR may not be the best financial appraisal.

For example (Dyson 2004, Mclaney& Atrill 2007) give the following reasons It does not maximise shareholders' wealth There is difficulty in handling projects with unconventional cash flows It gives only an approximate rate of return It can be misleading especially where there are negative net cash flows in subsequent years and when one project has to be opted for in favour of another i. e. mutually exclusive project. Conclusion

Hotel renovation is an inevitable process especially if hoteliers wish to secure their positions in the marketplace and also keep up with the constantly changing needs of the consumer. The two investment appraisal methods i. e the NPV and IRR usually used by decision makers Moreover the customer be it a business traveller or holiday maker is the most important element to the hospitality industry, to such a customer, the most important criteria are an

appealing image, safety and security, standard of service and most of all value for money.

Leaders in the industry must in no uncertain terms ensure that they meet expectations. So regardless of the financial appraisal techniques considered in the decision making process, hotel renovations are a must unless hoteliers are looking to reposition further down the market for instance choosing to go two star(2) or three(3) then they could be justified if they chose not to renovate otherwise they should be aware that they stand the chance of loosing market share if they do not renovate when required.

Reccommendations

Although investment decisions are carried out in the hope of generating future returns, the most important question hoteliers should be concerned with is whether they will be in business if they compromised their standards and quality of service by not repositioning as a result of lack of funds. The following suggestions have been given to serve as a guide to hoteliers wishing to renovate in the near future. Due to the costly nature of renovation, hoteliers could consider alternative sources of capital such as loans that offer low interest rates and low down payments that are unlikely to change during the period of the loan.

Also hoteliers must endeavour to give priority to areas that need immediate attention, they can achieve this by segmenting the market in order to identify the needs of the market that way they are able to know what to accomplish in the shortest possible time without breaking the bank. Again in the present downturn, hoteliers must find ways to cut down on renovation

expenses. For example if there is a choice of choosing between minor renovations such as the changing of bedding, drapes, curtains etc to major renovations that deal with heavy equipments, hoteliers will be better off going for minor renovations.

Moreover they could also seek advice (in terms of selecting contractors and experts that are willing to offer reasonable rates) from hoteliers that may have undertaken a similar project. In addition, Harris & Joanne (2003) advice that the best time to undertaken renovations should be less busy periods. Executive Summary The concept of repositioning was looked at in terms of two hotels. It looked at the repositioning and renovation concept.

It was realised that the main reasons for carrying out these renovations was to satisfy the customer in order to ensure repeat business, differentiate form other competitors to maintain a leading position, open new markets, and also increase profitability. In order to achieve this certain decisions had to be carried out, emphasis was placed on two investment appraisal methods i. e the NPV (Net present value) and IRR (Internal rate of return) since hotel renovation involved a great deal of budgeting. It was realised that regardless of the investment appraisal methods, hotel renovations was inevitable.

The conclusion was hoteliers had to renovate if they wanted secure the business in the constantly changing environment and also if they wanted to meet the changing needs of the consumer. It may be that they repositioned by default? Journals Ahmed Hassien, Tom Baum(2002) Hotel repositioning through property renovation. Tourism and hospitality research Vol. 4 p. 144 Beirne, Mike(2004) Crown plaza’s bed time story Brand week Vol. 45 , pp.

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