

**Hotel Investment Strategies**

# How To Manage The Lower Returns Of Luxury, 5-Star Hotels

**A**s a hotel appraiser, I have evaluated the financial performance of thousands of lodging facilities throughout the world. Some are immensely profitable while others are financial failures. In general, the more complicated, 5-star properties tend to produce lower returns to their owners than the simpler, mid-rate, limited-service variety. While the chain-affiliated luxury hotels such as Four Seasons, Ritz-Carlton and Mandarin Oriental usually perform far better than their independent counterparts, as a whole, the luxury sector has difficulty producing financial returns that are commensurate with their more down-scale counterparts. What are some of the reasons for this dichotomy and what can luxury hotels do to improve their financial situation?

Five-star hotels cost substantially more to construct than the typical limited-service property. In today's environment, a luxury facility could cost as much as US\$400,000 to US\$600,000 per room to develop, which is probably eight to 10 times more than an economy hotel. In theory, this means that the rate structure of the luxury alternative also needs to be eight to 10 times higher, which is generally not achievable. Herein lies the first problem: Luxury hotels often cost more to build than their markets can support. While over time local room rates escalate and the financial picture improves, in essence, the hotel owner actually is subsidizing the stay of his or her guests!

## Money Drains

The level of service required to achieve 5-star status is another financial challenge facing luxury operators. Areas such as the gourmet restaurant, 24-hour roomservice, swimming pools and turndown service are often huge money drains because of their labor intensity. This is coupled with an inability to charge a sufficient price for these services. While it may actually cost US\$75 to prepare, deliver and clear a roomservice breakfast, most hotels are unwilling to charge an amount that would truly cover this expense. Instead, they write it off as a "loss leader" required for maintaining their 5-star recognition.

I agree that luxury hotels need a few "loss leaders" to achieve their appropriate level of prestige, and I also realize that luxury costs significantly more to develop than mid-rate. But there are many overlooked opportunities for 5-star properties to enhance revenues, reduce expenses and greatly improve the financial returns to their owners. Here are a few ideas I have seen work during my travels.

Find a way to make every department a profit center. If you must provide 24-hour room service, then keep the kitchen open

and active during the night hours preparing food for new and unique venues such as off-premise catering for nearby offices and businesses. Open a gourmet take-out, retail food store, bakery, candy and flower shop. Push to sell more banquets and special events, which are much more profitable than a gourmet restaurant. Some hotels even use their high-priced cooking talent to teach cooking classes for hotel guests. You want every square foot of space and every employee in use full-time making money.

## Essential Amenities

If you do not have a full-service health spa and a complete, high-tech business center with meeting and conference rooms, find a way to fit them in. These are now essential 5-star amenities that, if managed properly, will quickly become important profit centers. Other sources of profit often overlooked by many hotels include the sale of logo items. But think beyond just clothing because a number of guests are willing to purchase items such as plates, glasses, silverware, kitchen utensils, hotel artwork, bedding and even hotel furnishings. Also, do not limit yourself to an in-house sundry shop. Set up a Web site store and sell your logo items to the world.

Profits are also achieved through expense reduction. In a luxury hotel, lowering expenses without compromising service can be difficult. Look for back-of-the-house opportunities such as waste management, recycling, energy conservation, improved workflow layout and functionality. Employ technology where actual labor reduction can be achieved. Today's new accounting systems, Web-based reservations, property management systems, recruiting Web sites and yield management programs will often produce staffing reductions and cost controls.

Operating a 5-star, luxury hotel using "time-tested" management techniques will probably not produce an adequate financial return. Hotel owners and operators need to think out of the box and develop creative approaches for building higher revenues and controlling expenses because every square foot and every employee must be a profit center. ♦



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