Case 15: Hospitality Co

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Case Question

- Our client owns a large hotel chain and is thinking about investing in an add-on for a waterpark on one of its properties. This has been tested in some places and has a lot of potential benefits: family friendly, year-round availability, and potential to bring in new clientele. They have done a lot of work surveying their chain and believe that they have found the right hotel to experiment with a waterpark add-on. Currently, this hotel has a lot of business travelers, but our client believes it would also be attractive for families.
- Our client is nervous about the capital required to build the add-on and wants to make sure that they are making the right investment. That's why we brought you on board. What do you think?

5
Quants.

5
Structure

Invest. B/E

Case tracker

- **Industry:**
  Leisure
- **Level of Difficulty:**
  Medium
- **Case format:**
  Opportunity Assessment
- **Concepts Tested:**
  - Investment
  - Breakeven analysis

Fit Questions

Spend first 15 min on fit

- Tell me about a time when you've had a conflict with a teammate.
- How would your friends describe you?
- How would you compare our industry with others you are interested in?

Guide to interviewer

- This case forces the interviewee to focus on the right issues and can be tricky. The candidate will need to ignore competitive positioning and focus on the profitability of the waterpark. The waterpark should recoup its investment and can even charge a premium.
- They will need to ask the right questions about the investment, its buyback period, and make assumptions about vacancy.
- There are also lots of potential risks and benefits that a great interviewee will recognize that allow them to consider the case on another level of detail.

Clarifying answers and case guide

Clarifying answers to provide

(Ignore any discussion of competition or market dynamics)

Competitive dynamics

- There are no competitors immediately nearby for a waterpark
- We have no information about competitors
- There is no possibility for a competitive response in the short run

Market information

- Our client has done proper diligence and has determined that this is the
- We do not have any specifics about the market and are unable to conduct additional survey data

Hotel characteristics

- Hotel's normal clientele is business travelers, but we believe that this waterpark will bring in families as well

Interview guidelines

This is a simple profitability calculation (Profit = Revenue – Costs) for the investment of a water-park add on. Many candidates will focus on the revenue side, but we need to back into the minimum amount the hotel *has* to charge to break-even on its investment in the payback period.

A sample case structure would include the following:

1) Cost structure - Identify the costs (fixed and variable) as well as the relevant payback period for the investment.
2) Breakeven analysis - Based on the estimated room rates and payback period, identify how much the hotel would have to charge (fixed + variable costs) for each room to breakeven over the life of the investment.
3) Additional risks and benefits – Qualitative assessment of other potential benefits/issues that may arise from the investment.

Math question and solution

Math question

- How much will the hotel need to charge per room to recoup its costs?

Math solution

The math is about backing into how much the hotel needs to charge per room over the course of the three years to recover its investment. The interviewee needs to ignore the variable cost and focus on how to spread the fixed cost of the investment over the payback period.

$6 million investment / 3 years = $2 million / year in revenues

400 rooms X 50% vacancy X 350 days (don't use 365) year = 70,000 rooms per year

(Many candidates will struggle with this, try to combine costs, and will make the difficult on themselves. Let them struggle for a few minutes before helping).

$2 million/year divided by 70,000 rooms/year = 28.6, or about $30/night in fixed cost

The candidate should add this with the variable cost for around $70/night total for the three year period. If they do not interpret the number immediately, ask them what they think about the $70/night total.

Math information

- Investment:
  - $6 million investment
  - Payback in 3 years
- Hotel:
  - 400 rooms
  - With waterpark, 50% vacancy on average for the year
- Cost structure:
  - Investment is fixed cost
  - Variable cost is $40/night per room

Key elements to analyze

Pricing decisions

- How should we interpret the breakeven point on the hotel costs?
- How do we think about pricing?

Other revenue streams

- What other potential benefits/revenue streams might this have?

Potential risks and issues

- What are the potential risks and issues associated with ?

Notes to interviewer

- The interviewee should realize $70 is an extremely low number, especially considering that families may be staying at the park.
- This will also ask the interviewee to gauge this number against the real cost of hotels and their personal experiences.
- Realistically, the hotel will be able to charge significant premium in addition to covering its basic costs.
- There are two options: charge an additional fee for waterpark entry or make it all-inclusive with hotel fee.

Notes to interviewer

- There are a lot of potential places to go here, but here are some ideas:
    - Charging admission entry
    - Food/restaurants at the park
    - Promotional tie-ins
    - Merchandise/swim suit apparel
    - Expansion to other hotels

Notes to interviewer

- Similarly, there are a lot of potential risks:
    - Management competency (do we have any experience?)
    - Regulatory/insurance risks
    - Health/litigation risks associated with theme parks
    - Competitive response
    - Alienating business customers with family friendly atmosphere

Solution and recommendations

Solution & Recommendations

- This project should be undertaken. While there are a number of potential risks and considerations (including competitive dynamics), the economics are extremely attractive and the price ($70/room) to earn back our investment is relatively low for almost any hotel, much less one with these amenities.
- The interviewee should make a solid case for their recommendation, using the other potential avenues for profit and the low payback price as key points for its undertaking.
- While the model answer suggests undertaking the investment, if an interviewee has a compelling, logical story on why the risks outweigh the benefits, it should be judged on its own merits. It would have to be a powerful argument though.

Bonus/Guide to an Excellent Case

- This case is defies a lot of candidate's expectations, with a lot of them really focusing on competitive/market dynamics. An excellent interviewee will get to the math quickly by focusing on the important issues: returning the investment.
- Additionally, an excellent interviewee will interpret the breakeven point as low. Asking them to "interpret" these numbers provides a good check of business judgment. Furthermore, an excellent interviewee will provide a lot of creative risks/benefits from this investment as well.