Turning Vacancy into Profits

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Vacancy is an issue faced by most hotel companies. For reasons such as competition, location, seasonality and/or lack of branding, many hotels operate at less than full occupancy during peak seasons. Vacancies also exist because some hotels choose to leave rooms vacant based on the premise that an empty room is better than a full room sold at a reduced rate.

This notion may stem from the fear that if some rooms are sold at a discount in the short term, then all rooms will need to be sold at a discount in the long term. Hoteliers may also be reluctant to partner with wholesale travel companies or tour operators out of fear of losing some control. Regardless of the reason, the end result is the same; should these rooms remain vacant indefinitely, a hotel may be limiting its income generation and market penetration. With less income and a smaller market, hotels may suffer from the following:

- a perpetual loss of income;
- an inability to meet the cash flow demands of the business;
- an inability to meet refurbishment costs to remain competitive;
- a greater need to reserve funds for capital programs; and
- an increase in costs to develop new markets.

Based on these issues, it would appear that additional room revenues, even at discounted rates, are beneficial to the bottom line.

Room Departmental Revenues and Costs
An increase in occupancy will have a direct impact on room departmental revenues as well as costs. Typical room costs range between 20 and 30 per cent of room revenue, which leaves 70 to 80 per cent of the additional revenue available for contribution towards other departmental costs, undistributed costs and fixed costs.

Other Departmental Revenues and Costs
An increase in occupancy will also provide additional revenue to other departments such as food and beverage, telephone and laundry. However, this increased occupancy will also lead to an increase in departmental costs. Departmental costs are also often expressed as a percentage of the associated revenue. Although these costs will be higher, the departmental profits will be higher in absolute terms.

Additional Costs
Undistributed costs are typically a function of total revenues and, as such, they will increase with additional room revenue. Fixed costs, on the other hand, tend not to fluctuate with rooms sold and will therefore not increase with additional room revenue.

The following table illustrates how a 20 per cent increase in the occupancy rate will increase revenues, revenue per available room and income before fixed expenses. This example reflects a hotel with 100 rooms, 50 per cent occupancy and a $90.00 average daily room rate.

Departmental Revenues	$000s		$000s	
Room 1,643 1,807				
Food & Beverage ($75.00 per room)	1,369		1,643	
Telecommunications ($10.00 per room)	183		219	
Other ($5.00 per room)	91		110	
Total Revenue	**3,286**	**100%**	**3,799**	**100%**
Departmental Costs [2]				
Room (25% of revenue)	411		452	
Food & Beverage (80% of revenue)	1,095		1,314	
Telecommunications (75% of revenue)	137		164	
Other (50% of revenue)	46		55	
Total Departmental Costs	**1,689**	**51%**	**1,985**	**52%**
Departmental Income	**1,597**	**49%**	**1,814**	**48%**
Undistributed Operating Expenses [2]				
Administration & General (10% of total revenue)	329		380	
Management Fee (3.5% of total revenue)	115		133	
Marketing (5% of total revenue)	165		190	
Repairs & Maintenance (3% of total revenue)	99		114	
Utilities (5% of total revenue)	165		190	
Total Undistributed Operating Expenses	**873**	**27%**	**1,007**	**27%**

1. Blended rate using 50 per cent of room rate on additional rooms sold
2. Expressed as a percentage of revenue for illustrative purposes only

On the one hand, by selling an additional 10 rooms at one-half the regular room rate:

- RevPar increases by 10 per cent;
- total revenue increases by 16 per cent;
- departmental income increases by 14 per cent; and
- income available to cover fixed expenses increases by 12 per cent.

On the other hand, this increased occupancy also causes:

- the average daily room rate to decline by eight per cent;
- departmental costs to increase by 17 per cent; and
- undistributed operational expenses to increase by 15 per cent.

Although there are several potential benefits associated with achieving higher occupancies - such as increased RevPar, revenues, cash flows, profits and market penetration - there are potential downsides as well.

As illustrated, there will be a reduction in the average daily room rate as well as increases in departmental costs and undistributed operating expenses. Additionally, there will be a breakeven point when the discounting of room rates is no longer profitable. Provided that hoteliers understand and consider these issues in the context of their operations, then the additional income from increasing occupancy can contribute to keeping a hotel competitive by providing extra funds for refurbishment, capital programs and marketing. So, vacancy does not necessarily have to leave you with an empty feeling or an empty pocket, if this vacancy is turned into profits.

This example does not represent an actual hotel and only reflects one possible solution. We recommend that any hotel contemplating a solution to a vacancy issue or other operational concerns perform a more detailed analysis, including sensitivities and breakeven, to ensure the optimal solution is achieved. Assistance from a hospitality industry specialist should also be considered.

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