

RED SPRUCE RESORT

Shannon Wright wrote this case under the supervision of Elizabeth M.A. Grasby solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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It was October 2014, and Jim Ellis, general manager of Red Spruce Resort (Red Spruce), had just finished a meeting with Mark Wakeman, director of rooms. Red Spruce, located in the Shuswap region of British Columbia, Canada, had just finished its 2014 season, so Ellis was looking for ways to increase occupancy for the next season. Wakeman had suggested that Red Spruce's suites were overdue for a renovation, and Ellis was eager to submit a renovation proposal to Venere Corporation (Venere), Red Spruce's parent company.

A suite renovation would help Red Spruce to compete with some of the newer resorts in the area, as well as increase the resort's nightly suite rate¹ and hopefully reverse the resort's declining market share. The renovation would also require a significant upfront investment, however, and Ellis wondered about its return on investment and payback period and how he could best pitch the renovation project to Venere.

THE CANADIAN RESORT INDUSTRY

The Canadian resort industry made up a portion of the country's hospitality industry and included establishments that offered short-term lodging and onsite indoor and outdoor leisure activities. Due to the space needed to offer these activities, resorts were primarily located outside of Canada's major cities. There were over 160 resorts in British Columbia.

Resort guests could be categorized as either corporate or leisure. Corporate guests visited resorts for offsite meetings and teambuilding retreats, while leisure guests visited resorts to enjoy a relaxing getaway that included more amenities and comforts than a camping trip. Leisure guests came in large groups for weddings or family reunions, but more often, they came in small groups, with an average size of three people. Each group of guests had its own criteria for selecting a particular resort, and before making their reservation, guests often searched online for a resort that suited their vacation needs.

The resort industry's performance was tied to the Canadian tourism industry's performance, and trends in the Canadian tourism industry heavily depended on domestic and international economic conditions. Growth in the Canadian tourism industry was forecasted to slow down over the next few years, although

¹ The price of one night's stay in a suite.

the remaining growth would be fueled by an increase in international tourist trips to Canada,² including an increase in American tourists travelling to Canada.³

Favourable market conditions increased competitiveness in the industry. In 2013, Canada ranked eighth on the World Economic Forum's Travel and Tourism Competitive Index.⁴ Canada's economic conditions, government regulations, infrastructure and natural and cultural resources proved advantageous, thus increasing competition among companies in the industry.⁵ To take advantage of the growing industry and the real-estate market, many resorts offered guests the opportunity to purchase timeshares⁶ of onsite property.

The Shuswap Region

The Shuswap region was a vacation destination, located in South Central British Columbia. It was a five-hour drive from both Vancouver, British Columbia, and Calgary, Alberta,⁷ and was centred around Shuswap Lake. The area was known for its mountain views, rocky terrain and lakes, and primarily targeted tourists in the summer months to enjoy activities such as hiking, biking, golfing, boating, watersports, cultural events and wine-tasting. The region was home to many species of fish, including sockeye salmon, the majority of the area was a provincial park, protecting it from over-development. While there were cabin properties owned in the region, visitors rented cabins or stayed at one of the region's 13 hotels and resorts, 21 bed and breakfasts or 19 campgrounds.⁸

RED SPRUCE RESORT

History

Red Spruce was a premium lakefront resort located in the Shuswap region. A family of early settlers to the area originally purchased the property in 1912 to use as farmland. When the rocky landscape proved too difficult for farming, they opened a lakeside bed and breakfast and used the property as a summer home for their family. The property stayed in the family and was used both as a resort and as a family retreat until Venere purchased it in 1997.

Ownership

Venere owned 35 resorts and hotels in Western Canada, and the company was in the process of purchasing additional resort properties in Ontario. Venere's management was not involved in the day-to-day operations of each resort or hotel, but the firm recruited a management team for each property that was responsible for the site's profitability. Venere exercised full control over major financial decisions, however, and it provided management training and marketing and financial resources to its properties'

² www.statista.com.proxy1.lib.uwo.ca/statistics/424169/number-of-international-tourist-trips-to-canada/, accessed June 29, 2015.

³ www.statista.com.proxy1.lib.uwo.ca/statistics/214778/number-of-us-tourists-visiting-canada/, accessed June 29, 2015.

⁴ Switzerland, Germany, Austria, Spain, the United Kingdom, the United States and France preceded Canada in the rankings.

⁵ www.statista.com.proxy1.lib.uwo.ca/statistics/186639/best-ranked-countries-in-the-travel-and-tourism-competitiveness-index/, accessed June 29, 2015.

⁶ An arrangement whereby several joint owners have the right to use a property as a vacation home for a portion of the year.

⁷ Calgary had a population of 1.4 million and Vancouver had a population of 2.4 million, Statistics Canada, October 15, 2015.

⁸ Shuswap regional website, <http://shuswaptourism.ca>, October 29, 2015.

management teams. Venere had invested \$5.5 million in improvements across all of its property holdings in 2014.

Operations

Red Spruce was open six months of the year, primarily attracting families in July and August and corporate retreats in May, June, September and October. Most family and corporate guests came from Western Canada's larger cities of Calgary or Vancouver. Red Spruce offered a full service spa, inflatable waterpark, pool, beach volleyball court, tennis court, nature trails and waterfront facilities to ensure that guests were never short of activities. The resort was a pet-friendly facility and offered a separate lake for dogs to swim. Red Spruce's facilities also included two conference buildings, which allowed it to service larger corporate groups, events and weddings. The property was home to three restaurants, offering all guests the options of fine dining and casual dining.

Red Spruce offered suite-style rooms that were outfitted with bedrooms, bathrooms, living rooms and kitchens. There were two types of accommodation at Red Spruce: suites and cottages. The suites included one, two or three bedrooms, and the cottages were four-bedroom cabins. Most of the cottages were sold as timeshares, but unsold properties were available for short-term rental to guests. All suites and cottages were close to the lake.

The Competition

Resorts competed with one another on offerings, location and price, and they measured their success on several factors, such as market share, occupancy and revenue per available room (REVPAR). Ellis considered the four resorts in closest geographic proximity to Red Spruce as the resort's direct competitors. Over the past few years, Red Spruce's competitors had invested heavily in room renovations and improving their onsite recreation activities, and consequently, Red Spruce's market share had decreased as fewer families visited the resort. To combat this decline, Ellis had decided to invest in the inflatable water park and had worked hard to improve Red Spruce's online presence and the effectiveness and aesthetics of the resort's website. The resort's market-share decline had slowed, but it still concerned Ellis. See Exhibit 1 for data on Red Spruce and its four direct competitors.

Collectively, Red Spruce and its four competitors earned \$29 million in revenue in 2012. Ninety per cent of this revenue was earned by three of the resorts: Blue Heron Resort & Spa (Blue Heron), Dunridge Resort (Dunridge) and Irvine House. These three properties were much larger than Red Spruce, offering 80,000, 137,000 and 48,000 room nights available annually, respectively. All three properties were open year-round, primarily offered hotel-style rooms⁹ and had renovated their rooms within the past few years.

Blue Heron

Blue Heron targeted couples with its full service spa, fitness centre, pool and lakeside views. The lakeside view from Blue Heron's rooftop terrace had been featured in multiple magazines and publications, promoting Blue Heron as an ideal location for weddings, meetings and events. Blue Heron had one bar lounge and three restaurants, offering guests a choice between casual and fine dining. Blue Heron did not allow pets on its resort property. Upon changing ownership in 2009, the Blue Heron property was entirely renovated, ensuring that all rooms and facilities were up to date and in keeping with the resort's luxurious brand.

⁹ Rooms that included multiple beds in one room and did not offer extra living space, kitchens or bathrooms.

Dunridge

Dunridge was a family resort that offered an inflatable waterpark, pool, two golf courses, paintball course, horse stable, treetop trekking course and boat tours. Dunridge remained open in the winter, offering its guests snowmobile tours, dog sledding, snowshoeing and cross-country skiing. Multiple recreation activities and three large spaces for events also made Dunridge an ideal location for corporate retreats and meetings. Dunridge was a pet-friendly resort.

Irvine House

Irvine House's facilities included two golf courses, a golf academy, five tennis courts, waterfront facilities, nature trails and one restaurant. This resort's award-winning golf courses attracted visitors who were interested in playing golf while its other recreational activities attracted families. The resort was not pet friendly.

Killoran Inn

Red Spruce's fourth direct competitor, Killoran Inn, split the remaining 10 per cent of industry revenue with Red Spruce. Killoran Inn was much smaller than Red Spruce and better suited to couples who wanted a quiet getaway. Killoran Inn was open year-round and it welcomed pets.

THE ROOM RENOVATION OPPORTUNITY

The Need

Red Spruce was dedicated to guest satisfaction, and management regularly reviewed TripAdvisor comments and room surveys to collect customer feedback. In 2013, 32 per cent of survey respondents indicated a need to upgrade the rooms.

Industry standards recommended that hotels and resorts upgrade their rooms every seven years. Ellis and Wakeman had previously decided that, in order to balance their spending on both rooms and leisure activities, they would renovate their rooms every 10 years. The cottages were newly constructed so they were not included in any renovation plans. Despite the owners' intentions, the rooms had not been renovated in 15 years, while the majority of Red Spruce's direct competition had recently undergone room expansion or renovation. Ellis and Wakeman believed these developments had contributed to the resort's declining market share.

During the 2014 season, film production crews had stayed at Red Spruce while on assignment. Ellis believed that this situation had caused an increase in 2014 revenue that would likely not be repeated in future seasons, so Ellis decided to base his forecasts on the 2011, 2012 and 2013 seasons. See Exhibit 2 for the resort's room rates and occupancy data for these three years.

The Proposal

Ellis was eager to completely update all suites, so the renovation would involve updating appliances, furniture, counters, tiles and decorations. Total renovation costs would exceed \$1 million; details are given in Exhibit 3. If pursued, the majority of the renovations would be completed over the winter so that full

benefit could be achieved during the 2015 season. It was important that a decision should be made quickly in order for renovations to begin immediately.

Ellis acknowledged that a renovation would be expensive, and he considered the option of not renovating the suites. If he were to pursue the non-renovation option, he wondered whether there was another way to combat declining occupancy rates.

Projected Costs

There were three main revenue generators at Red Spruce: food and beverage operations, recreation activities, and room¹⁰ reservations. Since food and beverage revenue and recreation revenue depended primarily on room occupancy, all three revenue generators would be affected by the suite renovation. Therefore, Ellis estimated the projected revenue, variable costs, labour costs and operating expenses during the renovation period, as shown in Exhibit 4.

While the revenues from food and beverage and from recreation activities were expected to stay at the same dollar amount per room per night, all room and occupancy rate changes were calculated using 2013 levels as a base. Room rates would increase by 4 per cent if the renovation was pursued and would decrease by 1 per cent if there were no renovations. Similarly, occupancy rates would change as well. If the renovation was pursued, room nights sold would increase by 3 per cent, and if there were no renovations, room nights sold would decline by 1 per cent. Even though the cottages would not be renovated, their rental rates would be increased by the same percentages.

Facilities management costs also varied. If the renovation was pursued, costs would decrease by 3 per cent, whereas no renovations would increase costs by 2 per cent. Facilities management expenses, not including the costs listed in Exhibit 4, amounted to \$136,053 in 2013.

Red Spruce's food and beverage manager purchased all food inventory on credit and paid suppliers within 14 days. Inventory turned over quickly, so Ellis considered any increase in food inventory on hand to be negligible.

Most guests paid all room fees in full at the end of their stay; however, Wakeman extended credit terms of 30 days to larger groups that visited the resort. Larger group stays accounted for 45 per cent of the resort's entire room revenue.

Ellis projected that other revenues and costs would grow with inflation, but he did not want to account for any additional growth when calculating the project's return on investment and payback period.

NEXT STEPS

Since Venere would be asked to finance this renovation, its management team had to approve Ellis's proposal. Ellis knew that Venere was considering several capital expenditures at its other holdings and that its Western Canada expansion was not as successful as hoped, so the management team might be reluctant to invest in the Red Spruce renovation. Regardless, Ellis was excited about the possibility of updating the suites, and he began considering what he should recommend to Venere.

¹⁰ Includes all suites and cottages available for short-term rental.

EXHIBIT 1: INDUSTRY STATISTICS – RED SPRUCE VERSUS DIRECT COMPETITORS (2012)

Metric	Red Spruce	Industry¹¹
Number of rooms available (supply)	11,311	294,830 ¹²
Number of rooms booked (demand)	6,818	135,296 ¹³
Occupancy	61.0%	45.9% ¹⁴
Room rate	\$206	\$222 ¹⁵
REVPAR	\$124	\$102 ¹⁶

Source: Company files

EXHIBIT 2: ROOM RATE AND OCCUPANCY LEVELS

Year	2011	2012	2013
Room nights available ¹⁷	11,830	11,311	11,830
Room nights sold	6,362	6,818	7,013
Occupancy %	53.8%	60.3%	59.3%
Average daily rate	\$204	\$206	\$213

Source: Company files

¹¹ Includes data from Red Spruce and its four direct competitors.

¹² Total.

¹³ Total.

¹⁴ Average.

¹⁵ Average.

¹⁶ Average.

¹⁷ Includes all suites and cottages available for short-term rental.

EXHIBIT 3: RENOVATION COSTS

Item	Cost
Design	\$ 22,600
Shower stalls	61,698
Bathroom tiles	44,916
Bathroom (other)	118,885
Dishwashers	18,730
Kitchen (other)	247,188
Lighting and ceiling fixtures	54,447
Art	16,950
Window treatment	49,720
Upholstery	78,812
Cased goods	133,484
Other furniture	45,672
Delivery and set-up	28,024
Construction	<u>169,500</u>
Total	<u>\$ 1,090,626</u>

Source: Company files

EXHIBIT 4: EXISTING OPERATIONS ASSUMPTIONS

	Food & Beverage Operations	Recreation Activities
Revenue (per room night sold)	\$165	\$12
Variable costs (% of corresponding revenue)	29%	10%
Labour costs ¹⁸ (% of corresponding revenue)	43%	87%
Operating expenses ¹⁹ (% of corresponding revenue)	4.4%	13%

	Room Reservations
Other revenue ²⁰ (% of room revenue)	8%
Variable costs	Negligible
Labour costs (per room night sold)	\$112
Operating expenses (per room night sold)	\$15

Source: Company files

¹⁸ The majority of food-and-beverage employees and recreation employees were compensated with an hourly wage.

¹⁹ Included overhead costs, such as utilities, repairs and insurance.

²⁰ Represents revenue from cancellation fees, administration fees, resort fees, service charges on group suites, pet fees and additional cleaning fees.