

Case study 13

Chapter 31: Costs and revenues

Lucia's Retreat

In 2009 Lucia Valenti bought a small hotel on the seafront in Viareggio. It had excellent sea views and 30 almost identical luxury hotel suites with excellent furnishings and en suite bathrooms. She catered essentially for business visitors who were able to pay premium prices. The hotel had a small restaurant, accounted for as a separate profit centre. This was used by residents and was also open to the public. Residents were given itemised bills which listed meals eaten in the restaurant as separate items.

When she first bought the hotel, Lucia had avoided signing contracts with coach tour companies because she did not think that this type of customer was in line with the high-class image of Lucia's Retreat's target market. She had set prices of €150 per suite per night and refused to reduce prices under any circumstances. Business clients were allowed one or two months' credit. This revenue covered her direct costs of around €25 per night, thus providing a healthy contribution. For this reason she did not offer unfilled rooms on any of the last minute or late rooms websites that required price cutting.

By July 2010 the hotel was struggling to make any profit and it looked as if Lucia was going to go out of business. Overheads had been covered by mid-June but in July and August Lucia's Retreat had fewer business visitors because at that time people took holidays and therefore went on fewer business trips. Cash flow was negative as Lucia tried to keep the hotel running with few of the rooms let out. At this point, BuzzAbout Ltd, a bus tour company, contacted Lucia. After a sudden rise in demand for touring holidays they were willing to offer €50 per room per night for all the rooms still available at that point through the rest of July and all of August. Lucia did not want to accept. The price offered was far below her usual price. Her chef encouraged her to sign the contract because, with so few guests, he was starting to be worried about cash flow and whether his next salary, at the end of July, could be paid.

SL questions: 20 marks, 35 minutes

- 1 Define the term 'premium prices'. (2)
- 2 Describe what is meant by 'direct costs' in the context of a hotel business. (3)
- 3 Explain the difference between revenue and cash flow for a business like Lucia's Retreat. (4)
- 4 Calculate the contribution for Lucia's normal room pricing and the contribution for the BuzzAbout reservation. (3)
- 5 Evaluate whether Lucia should accept the BuzzAbout reservation. (8)

HL questions: 25 marks, 45 minutes

- 1 Define the following terms:
 - a contribution (2)
 - b overheads. (2)



- 2 Analyse whether Lucia's chef should be concerned about whether his next salary will be paid. (6)
- 3 Explain how the restaurant may be run as a separate profit centre. (6)
- 4 Evaluate qualitatively and quantitatively whether Lucia should accept the BuzzAbout reservation. (9)