

TRT3701

Hospitality Management

Learning unit 3:

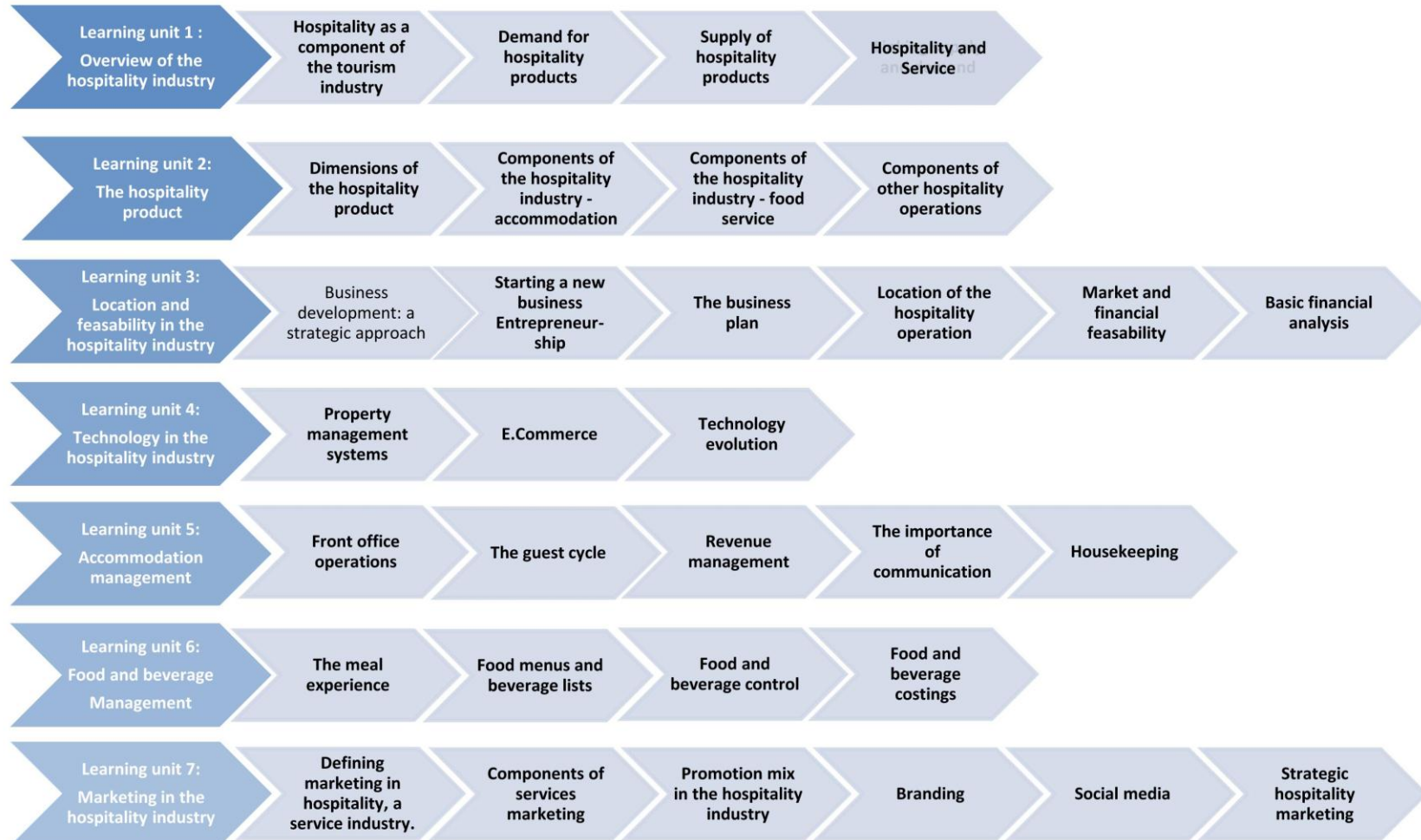
Location and feasibility in the hospitality industry



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The Hospitality Management Model: A Schematic overview of the module content



LEARNING OUTCOMES

Once you have completed this learning unit, you should be able to

- discuss the significance of the location of a hospitality operation
- define and apply the components of a financial feasibility study
- discuss the strategic management approach of a hospitality operation and its development strategies
- review entrepreneurship in the hospitality industry
- develop a business plan for a hospitality operation
- analyse the location of a hospitality operation
- demonstrate basic financial calculations

3.1 INTRODUCTION

This learning unit will explore the entrepreneurial characteristics required when starting a hospitality business, but will also focus on some of the strategies needed to remain competitive within an existing hospitality business. It will provide information on why it is important to choose the most suitable location for the business, as well as some of the essential facilities which need to be considered when making this choice. You will be guided on how to do a basic financial feasibility study: to work out if there is sufficient balance between supply and demand of the product, and to see whether your business will be sustainable in the location you have chosen.

3.2 BUSINESS DEVELOPMENT: A STRATEGIC APPROACH

The tourism industry provides a wide scope of business opportunities in a variety of tourism-related products and services. Contributing not only as an economic force, but also as a sociocultural force, its significance continues to grow (Walker & Walker 2012). Walker and Walker (2012:33) quote Presby by stating: “Tourism brings growth opportunities for the economy. Overall, it really helps keep small business open.” Starting a hospitality business, or even modifying an existing hospitality business, requires a concise and strategic approach as well as a fair portion of entrepreneurial spirit. Hassanien, Dale and Clarke (2010:9) summarise business development into four main strategies:

1. *Market penetration strategy.* This strategy operates within the existing market and focuses on increasing the market share of the existing product. For example, a hotel can increase its market share through heavy advertising across a variety of media, such as television, radio, newspapers and magazines.
2. *Market development strategy.* This strategy focuses on developing and finding new markets for an existing product. A hotel group could introduce their hotel into new geographic areas, including other countries. For example the Hilton hotel group who entered the African market.
3. *Product development strategy.* This strategy focuses on developing new products for an existing market. A hotel could introduce new products and services for example, wine pairing evenings in their dining facility, to satisfy their existing market 's needs and to increase sales.
4. *Diversification strategy.* This strategy focuses on developing a new product and selling it to new markets. A hotel could add new products, for example including a spa package, to cater for the new wellness market.

The position of each of these strategies is illustrated in figure 3.1.

		Products	
		Present	New
Markets	Present	Market penetration	Product development
	New	Market development	Diversification

Figure 3.1: Business development strategies

Source: Adapted from Hassanien et al (2010:11)

For hospitality operators, a combination of both market and product strategies is used to increase the existing market but also to attract new market segments.

Example: An existing leisure hotel would like to attract more business guests, by upgrading the technology in hotel rooms and conference facilities, that they could potentially attract business travellers and conference groups. This will also grow their leisure market as conference rooms can be used as entertainment facilities, such as a wedding venue, during holiday periods. They have therefore increased their existing market (leisure) and attracted a new market (business and conferencing)

This example refers to a combination of strategies that was used to expand market share, increase sales and to reach new markets:

A product development strategy: New product in the existing market

A diversification strategy: New product and new market

Business development involves a number of different routes. Figure 3.2 provides an overview of the different hospitality development routes. By following different routes, the hospitality organisation is able to enhance the performance of their business and/or their products.

Development routes include the following (Hassanien et al 2010:11):

- *New products.* On completing market research, the hospitality business may develop a new product or service which is currently needed in the market, but not offered by any of its competitors. A process of design and development should be followed to ensure that the product is sustainable in the market and that a return on investment will be received. A hotel could develop a new product, for example, offering a local cultural experience, such as cultural dances at the dinner establishment.
- *Innovation.* By promoting a culture of innovation and valuing the ideas presented by employees, the hospitality business can maintain a competitive advantage over its competitors. Innovation can be related to new product ideas or even ideas of enhancing current service or product offerings. For example, using technology, such as mobile phones and tablets, to interact with guests at any convenient time or location and enable guests to check in on-line.
- *Improved products.* Consumers become used to existing products and may go elsewhere to seek new options. Hospitality businesses should review products regularly and enhance or rejuvenate current products with additional features in order to remain attractive to their consumers and competitive within the market.

- *New segments.* Changes in demographic and consumer lifestyles may urge the hospitality business to approach new market segments which have not been available previously. For example, an increase in health and wellness has encouraged many hotels to offer spa packages or relaxation breakaways to markets pursuing a healthier lifestyle.
- *New markets.* Growing economies in Africa and Asia have created a global platform for hospitality organisations to expand into new markets. Major hotel operators, such as Holiday Inn and Hilton International, now enter these markets and expand their brand into a number of new locations. For example, Hilton Worldwide opened a regional office in Johannesburg to exploit growth opportunities across the African continent.
- *New uses.* Declining sales, new market opportunities and changes in market trends may encourage hospitality businesses to find new uses for their existing products or facilities. A traditional restaurant facility can become a dinner dance venue on specific nights of the week, for example. By creating an additional use for the premises, additional revenues can be generated and new market segments can be explored.
- *Withdrawal.* Should the cost and resources of offering the product become no longer feasible, the hospitality business may withdraw the product from the market. This could be as a result of increased competition, changes in market trends or a shift in demographics which have negatively affected sales of the product.
- *Consolidation.* When hospitality businesses decide to merge or sell one business to another, consolidation occurs. Consolidation is often the result of an over-saturated market where too many competitors sell similar products and it becomes difficult to compete for the same share of the market. One business may then offer to buy another business in order to remain competitive. For example, Tsogo Sun's consolidation of two of its hotels on the Durban beachfront into one "mega Sun" hotel.
- *Penetration.* If there is further growth potential in the current target market, the hospitality business may decide on a strategy to improve the quality of their service and product, and in so doing try and penetrate the market for an increased share of the sales. The hospitality business however has to be assured that there is scope for the market to buy more of the same product. For example, a hotel can increase its market share through advertising.
- *Related diversification.* Related diversification is a result of the hospitality business entering into product areas related to their current core business. This

strategy allows them to increase market presence and exploit further growth potential. For example, a full-service luxury hotel company decides to build limited service budget hotels. They are already familiar with the core product and will use this as a base for their new product. An example includes Tsogo Sun who introduced the Stay Easy and Garden Court Concept.

- *Unrelated diversification.* When a hospitality business decides to develop a product which is unrelated to its existing core business it is known as unrelated diversification. The business would either need to build internal resources to do this, or would have to acquire a firm to operate in this field. The potential risk of exploring such an unrelated and perhaps unfamiliar market would need to be assessed very carefully, as the core business may be put at risk. For example, a hotel group decides to produce, bottle and label its own branded wines.



Figure 3.2: Overview of hospitality development routes

Source: Adapted from Hassanien et al (2010)

Strategies and the different hospitality development routes are pursued by hospitality businesses to achieve competitive advantage to attain their long-term objectives. In the

long-term these strategies will enhance the performance of their business and/or their products.

With more insight into the different routes to develop a hospitality business, we can look further at the requirements for starting a new hospitality business.

3.3 STARTING A NEW BUSINESS

Most people dream of owning their own successful business. It however takes careful planning to take a business idea or concept and turn it into a successful business venture (Hassanien et al 2010:147).

A few key considerations need to be taken into account, when wanting to start a new business:

- The proposed design concept: Is there potential demand for the proposed business?
- The proposed site. Is it the right location?
- Transportation/Access. Is there sufficient logistical support to make the business successful?
- Existing supply. Is there a gap in the market, or is the product significantly different to create new demand?
- Competition. Who will be your competition?
- Planned additions. Can the business facilities be expanded?
- Economic/Social climate.
- Sources/Characteristics of existing demand.
- Future demand and likely market share.
- Projected operating statements.
- Cash flow projections and investment appraisal: Are the financial projections realistic and realisable?

The global, well-known franchise, McDonald's, started with similar considerations and questions. After much market research, they appear to have found the recipe for

success, and have turned McDonald's into a franchise chain represented in virtually every country in the world.

McDonald's has become a world-famous brand name and has also become a household name in South Africa. The large BIG M, also fondly known as the "golden arches", is visible from a distance. The location of their outlets is so important to them that McDonald's puts large amounts of money into getting the best possible location. McDonald's is one of the world's prime owners of the best locations (prime property owners). They concentrate on areas with large population flow (feet traffic) and ensure that the big M is highly visible.

This is however not coincidental. After starting the business, McDonald's executive management were most likely faced with the three critical questions related to the strategic management of their business (Gamble & Thompson 2011:2):

1. Where are we now?
2. Where do we want to go?
3. How are we going to get there?

By exploring the three critical questions, the initial start-up business would have been carefully examined. Gamble and Thompson (2011:2) unpack these three questions within a strategic approach.

- **Where are we now?**

This would review the potential financial performance of the business, its future position in the market and how competitive the product offering will be?

It would also review the competitive weaknesses: where the competition is stronger, as well as industry conditions that may affect the business.

- **Where do we want to go?**

This would be incorporated in the company's vision for its future, the potential new markets it wants to serve and what changes, if any, the business would need to make to realise the vision.

- **How are we going to get there?**

This not only involves management planning in order to reach the goals set by the vision, but often also requires the business to establish a plan of action and stay ahead of their competition, rather than reacting to the environment.

Watch this! “Big Mac - Inside the McDonald’s Empire”

A behind-the-scenes look at the world's most successful restaurant chain!

This video looks at how a hamburger stand grew into one of the most famous brands on the planet. McDonald's serves 52 million people daily.

<http://www.youtube.com/watch?v=c2RyMgDbuGY>

ACTIVITY

1. Access the website www.mcdonalds.com.
2. Read more about the “story” of McDonalds and how the business started.
3. Read more about the history of McDonalds and how the business evolved from just a hamburger restaurant to the success it is today. Look at the number of countries where McDonalds is represented.
4. Access the website www.mcdonalds.co.za
5. Read more about the “story” of McDonalds in the South African context.
6. Explore the key facts, to see what contribution this dynamic company has made to the South African economy.
7. Can you identify how McDonalds applied the three strategic questions to their vision as a burger restaurant? Think about a McDonalds restaurant: Do they only serve burgers? How has their product changed/expanded?
8. Who owns McDonald’s in South Africa?

ACTIVITY FEEDBACK

Your review of the websites would show how McDonalds (USA) was started by Ray Kroc, a humble salesman. His vision turned a small hamburger restaurant into an internationally known franchise.

Careful planning and a strategic approach allowed for McDonalds USA to expand globally, also capturing the South African market. The contribution McDonalds has made to the South African economy is significant and the brand continues to grow throughout Southern Africa.

A company's business strategy is strongly related to the question "how to get there?" (Gamble & Thompson 2011:3). A strong business strategy should consider the following issues:

- changing economic and market conditions
- features and attributes to be included in the company's products and services
- pricing of the company's products and services
- distribution channels selected for the company's products (how does the company intend to get the product to the customers?)
- reactions to potentially offensive moves by rival sellers (how will the business/company react to the competition?)
- allocation of the company's financial resources
- development of internal capabilities, competencies and competitively valuable resources
- development of alliances and joint ventures to supplement the company's resources and capabilities

A number of actions and approaches are therefore associated with a company's business strategy. These actions and approaches are presented in figure 3.3.

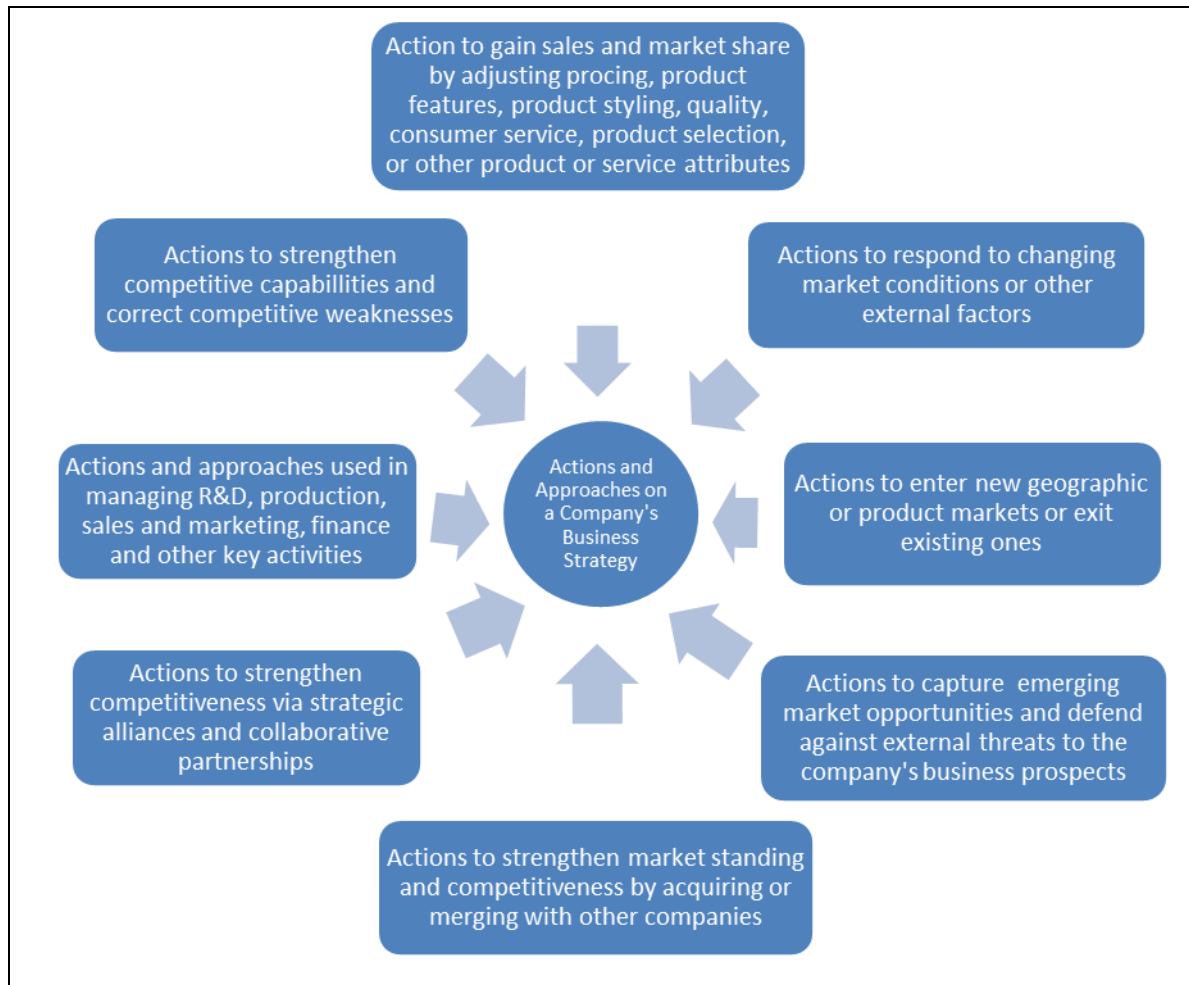


Figure 3.3: Elements of a company's business strategy

Source: Adapted from Gamble and Thompson (2011:4)

You should now have an overview of what a company strategy should look like as well as the key considerations for starting a business. Let's look at entrepreneurship and some further processes in starting and managing a successful business.

3.4 ENTREPRENEURSHIP

The tourism industry, and its diverse products and services, has the potential to give local entrepreneurs the opportunity to build, own and operate a small tourism business, such as a hotel, guest house or restaurant. A good example of successful local

entrepreneurs in South Africa would be Robert and Fernando, two friends who started a chicken restaurant called Nando's.

For this opportunity to become a reality, it was necessary for these two gentleman to follow the "entrepreneurial approach". Brymer and Hashimoto (2007:70) best define entrepreneurs as follows: "Entrepreneurs are willing to take action and pursue opportunities that others typically view as too risky, nothing but problems and threats." In general, an entrepreneur is not just someone who starts a new business, but also someone who can see opportunities to expand an existing business.

An entrepreneur has the following characteristics:

- sees an opportunity to make money (often by providing a product or service for which there is a need)
- has the ability to combine production factors in such a way that a profit is realised
- thinks of a plan to start a business or expand an existing business and is motivated enough to follow it through to its successful implementation
- is in effective control of a commercial undertaking

Brymer and Hashimoto (2007:71) refer to Ray Kroc's (founder of McDonalds) statement that the principal reasons for his success were:

- the ability to react positively to challenges and learn from his mistakes
- taking personal initiative
- perseverance and determination

Basic entrepreneurial attributes will greatly benefit anyone who considers starting a business. A business person must be able to recognise an opportunity and then have the necessary knowledge and skill to exploit it. The entrepreneur should also have qualities such as perseverance (especially in the face of adversity and obstacles), leadership and the ability to communicate effectively with others. Their behaviour is dynamic, risk taking, growth oriented and often creative (Brymer & Hashimoto 2007).

Most successful business people are those who have the strongest drive to achieve. Making a profit is one way of measuring whether a job was done well; the realist also relies on feedback from customers to measure his or her performance, especially in a customer service industry such as the hospitality industry. Guest or customer feedback is essential to determine whether or not the product/service provided satisfies the needs of the target market.

ACTIVITY

Search the internet for “successful entrepreneurs in the hospitality industry”. See which of these entrepreneurs you recognise and then answer the following questions:

1. What sector in the hospitality do they operate in (type of business)?
2. How long has the business been operating?
3. In which area are they operative?
4. Which target market are they servicing?
5. How do you personally view this business? Are they successful or are they struggling?

ACTIVITY FEEDBACK

You may have recognised entrepreneurs such as Conrad Hilton, the founder of the Hilton Hotel group, or JW Marriot of Marriot Hotels. Most of these entrepreneurs started with a small business idea and, over time, displayed the necessary entrepreneurship behaviour and competitive strategy to grow their business.

Most successful businesses are built up by combining entrepreneurial qualities with a sound business idea, a supporting business plan and adequate financing.

3.5 THE BUSINESS PLAN

A properly prepared, detailed business plan will provide the basis of the new venture as well as a frame of reference for prospective financiers. Brymer and Hashimoto (2007:76) define a business plan as follows:

“ ... a detailed plan that identifies the opportunity, the resources needed, the team make-up, the market, the operating plan, the risks, required finances, and an exit plan for a specific proposed business venture”.

Various formats of business plans are available on the internet, and financial institutions also offer client services to assist potential business owners with the requirements of such a business plan.

The following table provides a detailed template for a hotel business plan.

Table 3.1: Guideline of topics to be covered in a hotel business plan

	Section	Topics to be covered
1	Introduction	Business description Business formation Directors Management team Business goals/mission Business philosophies/identity Geographical markets Vision of the future
2	Executive summary	Main objectives Sales summary Strategic positioning Strategic alliances Licences Key advantages Funds required
3	Marketing	The product mix Sales estimates Analysis of current product mix Competitive research Market analysis Marketing goals and strategies Pricing policy Advertising and promotion Sales management SWOT analysis

4	Historical analysis	General view The market position Historical balance sheet (if available)
5	Organisational structure	Administrative organisational structure Management and personnel Contingency planning
6	Operations	Identity Location Layout
7	Financial plan	The investment budget (capital) Statistical data (ratios) The return on investment (ROI) Financial projections (forecasts) Projected occupancy levels
8	Risk management	Risk reduction Exit strategy
9	Appendices	Personal income statement Other

Source: Adapted from Hassanien et al (2010)

When reading the business plan, the potential investor or financial institution must be able to clearly communicate the business idea and how it will be put into operation. If the plan is incomplete or vague, financiers may deny finance purely on the basis of not being able to assess whether the risk is too great and whether the business would actually be viable (Hassanien et al 2010).

ACTIVITY

1. Would you like to start your own business one day? If so, what type of business would it be?
2. Log on to any one of the major financial institutions (banks) in South Africa (e.g. www.standardbank.co.za). Look for the icon/link to business banking.
3. On the website, the bank will provide information guiding you through the process of starting a business and drawing up a business plan.
4. The site also gives tips on how to get finance, as well as other tips.

ACTIVITY FEEDBACK

You will notice that the financial institutions have very strict guidelines on the information they require before they provide funding for a business. Since South Africa is a developing country, financial institutions provide the services of business bankers to help new business owners and give guidance on drawing up their business plans and submitting their finance applications. The bank will only provide finance when the necessary business plan and all its key features are clear and the business can be seen to be financially feasible.

Watch this! “Learn How to Start a Catering Business - turnkey business models”

Watch the following video to learn how to start your own home based or commercial catering business: <http://www.youtube.com/watch?v=bFHGvWHsa5M>. In this video catering business owners provide valuable guidelines on how to start such a business. You can also visit their website <http://www.startacateringbusinessnow.com> for more information.

ACTIVITY

Entrepreneur magazine, published by Entrepreneur Media SA (Pty) Ltd, is one of South Africa’s top business magazines. This wonderful magazine focuses on business owners and key decision makers. The magazine, together with its website (www.entrepreneurmag.co.za) offer wonderful sources of information and “how to” guides for South African entrepreneurs who want to grow their businesses.

Log on to the [Entrepreneur](http://www.entrepreneurmag.co.za) website.

1. Would you like to start your own business one day? If so, what type of business would it be?

2. On this website, you will find a taskbar to the left, guiding you through a business plan. The site also gives tips on starting a business, how to get finance and a number of other tips.
3. What features would you need to cover to start your own business? Read more about each feature on this website.
4. What other successful South African entrepreneurs can you think of? Search for more examples on the internet.

ACTIVITY FEEDBACK

Starting your own business requires careful consideration and thorough research into a number of features. Often sparked by an idea to fill a need in a specific market, the entrepreneur will start a business based on consumer needs. Think of examples such as Robert and Fernando who started [Nando's](#) or international hospitality entrepreneurs such as Conrad Hilton who started the [Hilton Hotel Group](#).

3.6 LOCATION AN IMPORTANT COMPONENT OF BUSINESS SUCCESS

Not only is a sound business plan essential to the success of a business, but very often the location also plays a vital role. A number of authors (Hassanien et al 2010; Gamble & Thompson 2011; and Brymer & Hashimoto 2007) agree that the location of the hospitality business plays a significant role in the success of the business. As hospitality is inherently a “service industry”, the client becomes a co-creator of the service product (Ford, Sturman & Heaton 2012). The McDonalds case study also stresses the importance of location as a major contributor to the success of the business.

The term "location" includes the land and the building on the premises. When a hospitality operator decides to open a business, it is necessary to decide whether to buy the premises or to rent it from a landlord. Although both options have their advantages and their disadvantages, this decision is usually influenced by the nature and type of the business to be opened.

When reviewing location, the following key components contribute to suitability (Ford et al 2012):

- access to customers/target market
- access to/availability of suitable suppliers
- availability of public facilities/basic infrastructure
- access to service personnel
- size and shape of the building
- potential future needs

3.6.1 Access to customers/target market

The success of any hospitality operation further depends on how accessible it is to its target market: how close it is to the people who will buy the product or range of products and services. This is where visibility and easy access play an important role. The evolution of technology has also demanded that hospitality operators, where possible, make their product accessible via the internet.

The type of operation and the operating hours of a business are also determining factors, since different hospitality operators serve different target markets, due to their location and product offering.

In essence, it is essential that a hospitality operator is located as close to the target market as possible so as to attract potential or regular customers/guests (Hassanien et al 2010; Barrows, Powers & Reynolds 2012). The access to potential customers via social media will be discussed in more detail in the learning unit on hospitality technology.

3.6.2 Access to/availability of suitable suppliers

Providing a consistent product and service is another essential component of business success. Certain basic products/supplies are important to ensure that the operation meets the needs of its target market. For example a restaurant cannot offer all the items on its menu if the necessary stock is not ordered, delivered and carefully monitored within the restaurant. In the same vein, a hotel's housekeeping department cannot prepare rooms without the essential guest supplies at hand.

This calls for reliable suppliers to supply essential commodities to the hospitality operators. The distance between the suppliers and the hospitality operator influences a number of decisions within the business. It is common practice for suppliers to plan their

routes of delivery based on geographical location of their clients. For the hospitality operator, this requires more careful planning and may influence the following decisions within the business (Humphrey & Halse 1987:45):

- The food production methods used (e.g. sous vide, cook-chill or cook freeze) depends on how often supplies are ordered and delivered.
- Ordering cycles (e.g. the supplier only delivers to the area on a Monday): hospitality operators in remote locations would need to consider this more seriously as major suppliers could possibly limit deliveries based on distance and accessibility to the premises. This is also influenced by the relationship that exists between the supplier and the hospitality provider. Some suppliers will bend the rules to satisfy the request of the operator due to the amount business done between the two.
- Pricing structures (e.g. the supplier may offer different prices and discounts on different order sizes or payment options). Suppliers can often give preferential pricing if orders are paid in cash, rather than purchased on credit. Higher fuel prices can result in higher food prices; as these price increases have to be calculated into the cost of the final product.

ACTIVITY

1. Visit the website www.hotelstuff.co.za and review the different types of items that a typical hospitality organisation may need to purchase.
2. Look at the number of suppliers listed for different categories of items.
3. Think of a specific hospitality product, for example towels for hotel rooms and search for a supplier for that product. Can you access a specific supplier's website to see what they offer?

ACTIVITY FEEDBACK

You will note that a large number of suppliers exist for a range of products in the hospitality industry. As a hospitality manager, you may want to contact a number of suppliers to request prices for a specific product. You can then compare the quality and the price of each product to see which supplier offers you the best price, the best quality and the best payment terms. These are your typical criteria for selecting suppliers.

You can also refer to the following websites for more information on hospitality suppliers and the products they offer:

- <http://www.has.co.za> (hotel amenities suppliers)
- <http://www.sa-suppliers.co.za> (variety of hotel and restaurant suppliers)
- <http://www.accafrica.co.za> (linen, cutlery and crockery suppliers)

3.6.3 Availability of public facilities/basic infrastructure

Another important factor to take into consideration when selecting an appropriate venue for a hospitality operator is the accessibility of amenities such as clean running water, electricity, roads, telephone lines, parking facilities and in some cases public transport. These are all important and are essential for any type of business.

Access to public toilet facilities is important, especially for food service providers. Not all food service operators have their own ablution facilities and are forced to rely on general public facilities provided by the buildings they are situated in. Think about restaurants situated in shopping centres, where the client may be required to leave the restaurant to use the centre's toilet facilities. There are pros and cons to both options. What do you think is the ideal situation in this regard?

Providing safe, adequate parking is another very important factor. Most clients will drive to a venue and will park their vehicle close to the venue while enjoying what the operator has to offer. Clients would also reconsider using an operator if the roads leading to the business are in a poor condition or unsafe to travel. Alternative operators in more easily accessible locations may then become more attractive.

3.6.4 Access to service personnel

The hospitality industry is a very labour-intensive industry and requires the expertise of many skilled and unskilled people, from individuals in management positions to those responsible for the most basic functions in the operation. Certain areas have greater access to skilled labour, training facilities and better public transport systems. Access to public transport may also greatly influence availability of suitable labour resources for the business.

For example, think about the benefits a restaurant in Sandton (in the Central Business District [CBD]) in Johannesburg has versus a restaurant in a country setting 70 km away from the CBD.

Hospitality operators may also use labour contractors to provide suitably skilled labour. Labour organisations such as [InnStaff](#), [HSC Staffing Solutions](#) and [The Prestige Personnel Agency](#) are some of the better-known companies in South Africa.

Where transport is hugely problematic, for example at a remote game lodge in northern KwaZulu-Natal, staff accommodation may be provided to relieve the impacts of transport on the operation. For example, the well-known Sun City resort has built an entire “staff village” on their premises, where supervisory and management staff are allocated a flat or house to stay in. Less senior levels of staffing, such as waiters, bartenders and housekeeping attendants are recruited from the local area (rural or urban) and staff transport is provided.

3.6.5 Size and shape of the land and building

Hospitality businesses usually have to meet specific requirements in terms of floor space utilised for rooms, public areas, kitchens and other facilities. If new buildings are built or existing buildings are converted into premises for hospitality operators, these regulations need to be followed. A key consideration in the construction of a hospitality facility is observing smoking legislation and health (HACCP) and safety requirements of the building. The cost of renovating an existing building for an hospitality operation can be substantial (e.g. turning a retail store into a restaurant). For this reason, the land and buildings need to be carefully considered.

3.6.6 Future needs

The future needs or growth potential of a hospitality business must also be considered from the initial stages. A business may decide to increase the floor space to

- enlarge the kitchen or preparation area
- increase the dining area
- increase the parking area
- add a conference/banqueting facility
- build additional guest rooms

Establishing a successful business on a premises which later limits the growth of the business could have a very negative impact on the sustainability of the operation.

The hospitality operator should also be one step ahead of his or her competition. The location of the business is often directly related to the competitive advantage (Gamble & Thompson 2011) and may contribute greatly to the growth and success of the business.

ACTIVITY

1. Think of a restaurant in your area and where it is located.
2. Critically review the location of the restaurant in light of the components which contribute to the suitability and sustainability of a hospitality location.
3. If you were the business owner, would you have chosen this location? What are some of the reasons for your answer (for or against)?

ACTIVITY FEEDBACK

You will now look at the location of hospitality operations more critically. A restaurant is not built in a particular place or in a particular shop in a shopping centre purely by coincidence. The business owner will have evaluated the location carefully in order to ensure the best possible exposure for his or her business. Have you ever noticed that restaurants move from one location to another in the same area? This is often related to the impact which the location had on the business.

3.7 MARKET AND FINANCIAL FEASIBILITY

Hassanien et al (2010:146) cite Ransley and Ingram (2000): “The purpose of a feasibility study ... is to provide an objective, independent appraisal of a development opportunity ... and sufficient information for the client (and others involved in the project) to make a decision as to whether the project should proceed and, if so, in what form.”

The key objectives of a **feasibility study** are therefore to (Hassanien et al 2010)

- evaluate the proposed business environment
- assess the existing supply and demand and hence the market requirements
- inform the potential lenders or investors
- provide evidence in support of planning applications
- assist in prior negotiations with management companies and other relevant agencies

In brief, a feasibility study deals with two major components: general market characteristics and market research, and a financial analysis.

3.7.1 General market characteristics and market research

According to Hassanien et al (2010:131) it is essential to consider the following when you do a marketing analysis:

- site location
- potential population growth of area
- employment and economic trends
- social concerns

When considering different markets, for example the leisure market, or the business market, the above factors may have a big impact on the future success of the business.

Leisure guests may not necessarily want to travel to a city centre for a holiday experience. Market segmentation (Hassanien et al 2010) is therefore important for the company to look at different markets, such as leisure, corporate, conferencing and government, to be able to sustain business revenues.

Hotels strategise their business plans for the future financial year, based on the marketing mix and potential revenue this will generate.

EXAMPLE

A hotel such as [Emperors Palace](#), near the OR Tambo International Airport, is a casino complex, with specialised conferencing facilities. However they have also successfully captured the leisure market, through ongoing specials on entertainment packages offered to leisure guests, as well as the wide variety of food and beverage facilities on the premises. At the same time, the gaming market is catered for as well as the business market (corporate and government) through trade shows, seminars, exhibitions, conferences and so on hosted at this venue (www.emperorspalace.co.za).

It is important for a hospitality business operator to use a marketing analysis to identify which markets in the marketing mix can be grown to increase revenues for the business.

The following factors may also impact the market (Barrows et al 2012):

- *Location of the business.* We have already discussed the importance of location, but it is also essential to consider factors such as site dimensions, existing improvements to sites and adequate space for future expansion. In order to grow market share, the business may need to make additions to the current business or embark on renovations in order to attract a new market.
- *Supply and demand information.* A new restaurant or hotel may be built if
 - the present demand is greater than the supply
 - the demand for a new market segment is not properly served
 - the present supply is not up to standard in terms of quality and quantity

It is therefore important to analyse the supply and demand situation very carefully to see whether there is a need for another hospitality provider. The following information must be obtained in this analysis:

- Assessing the occupancy trends in terms of the number of hotel guests and the occupancies for the last five years; these trends should be further broken down into the class or status of the establishment (e.g. upmarket, mid-range or economy). Star ratings of hotels would also be a valuable benchmark for analysing the market segment the hotel will serve.
- A list of the current providers within the market segment should be compiled and then classified according to competitive outlets, less competitive outlets and nonperforming outlets. This will give a clear indication of the strengths and weaknesses of the business. Learning from a competitor's failures and successes often saves you from making similar mistakes.
- An understanding of the main source of demand and the target market. An exclusive private game lodge (e.g. Madikwe Game Reserve) for example, will target foreign tourists, business executives and wealthy local travellers; due to their superior and luxurious product offering.

A good source of this information would also be the local business chamber, the Federated Hospitality Association of Southern African (FEDHASA), SA Tourism or other organised tourism organisations.

- *Supply and demand analysis.* Once the necessary information has been compiled and assessed, it can be used to decide whether additional operators within the area are justified.

The following example shows how a four-step analysis can be used to ascertain if additional business of the same nature, such as another hotel, is needed in the area. This would also give you insight into the demands of the market you will be serving. (This example applies to hotel operators.)

EXAMPLE

Step 1. Calculate the most recent 12-month average occupancy of the most competitive businesses (hotels).

There are five competitive hotels in a specific area and their total number of rooms and the occupancy of those rooms are as follows.

Table 3.2: Calculating the average number of rooms required per night for the market (average nightly demand)

Hotel	Number of rooms	Average occupancy	Average nightly demand per hotel
1	250	64%	160
2	150	72%	108
3	300	80%	240
4	225	68%	153
5	175	84%	147
TOTAL	1100	73.45%	808*

The total average nightly demand for the five hotels is **808*** rooms. The average annual occupancy based on the figures above can be calculated by dividing the average nightly demand by the total number of rooms available.

$$808 / 1100 \times 100 = 73.45\%$$

Step 2. Calculate the **composite growth** rate of demand from the various sources.

The following data was extracted from the information provided: **source of demand**, **annual compound growth** and **composite growth**.

Table 3.3: Composite growth based on source of demand

Source	Source of demand	Annual compound growth	Composite growth		
	Source of demand	x	Annual compound growth	=	Composite growth
Business /Corporate travel	50%	10%	5%		
Conventions/ Conferences	45%	15%	6.75%		
Leisure groups	5%	10%	0.5%		
	100%		12.25%		

The **composite growth** can be calculated by multiplying the **source of demand** with the **annual compound growth** (eg $50\% \times 10\% = 5\%$). The annual compound growth rate figure can be ascertained from the historical growth rate figures projected by the business.

Step 3. Calculate future demand for rooms on a yearly basis.

The future demand for rooms is calculated by looking at 100% occupancy plus the composite growth of 12.25% ($100\% + 12.25\% = 112.25\%$).

Table 3.4: Future demand for rooms (yearly projection)

Year	Demand	Composite growth	Future demand
1	808	112.25%	907
2	907	112.25%	1 018
3	1 018	112.25%	1 143
4	1 143	112.25%	1 283
5	1 283	112.25%	1 440

Step 4. Calculate the future number of rooms required

In the hotel industry, an occupancy of 70% is regarded as the norm. An occupancy rate in this region means that the hotel will be profitable. From the calculations above, the annual occupancy rate for the competitive hotels is 73.45% (Step 1).

The current need for additional rooms based on a 70% occupancy rate can be divided by the average nightly demand (Step 1).

Thus, $808/70\% \times 100 = 1154$ (Future number of rooms required)

From the figures above, it is clear that there is a current shortage of rooms. How do we calculate this?

$$1\ 154 - 1\ 100 = 54$$

(Future number of rooms required – Total number of rooms = Shortage of rooms)

Should a new hotel with 54 rooms be built, the overall occupancy of the region be:

$$808/1154 \times 100 = 70\%$$

(Average nightly demand / Future number of rooms required x 100)

This outlines a simplified overall picture for a new hotel establishment. By building a hotel with additional rooms, the shortage of demand is met and the average occupancy of the region will be 70%, putting it well within reach of profitability. It is then up to the operator to ensure competitive advantage to secure a higher percentage of the business.

ACTIVITY

1. Complete the tables below by calculating the missing fields (indicated by the letters (A) to (D)).

Source	Source of demand	Annual compound growth	Composite growth
Business/Corporate travel	60%	5%	(A)
Conventions/Conferences	35%	8%	(B)
Leisure groups	5%	12%	(C)
	100%		(D)

ACTIVITY FEEDBACK

Source	Source of demand	Annual compound growth	Composite growth
Business/Corporate Travel	60%	5%	3%
Conventions/Conferences	35%	8%	2.8%
Leisure groups	5%	12%	0.6%
	100%		6.4%

Overall the results (D) show that the business expects total growth of 6.4% (3 + 2.8 + 0.6) on an annual basis.

ACTIVITY

Question 1. Calculate future demand for rooms on a yearly basis, if the composite growth rate is 7.25%. The current nightly demand is 912 rooms. Remember to round off your answer.

Year	Demand	Composite growth	Future demand
1	912	A	(b)
2	C	(d)	(e)
3	F	G	(h)
4	I	J	(k)
5	L	M	N

ACTIVITY FEEDBACK

Year	Demand	Composite growth	Future demand
1	912	(a) 100+growth rate = 107.25%	B 912 x 107.25% = 978
2	C 978	(d) 100+growth rate = 107.25%	(e) 978 x 107.25% = 1 049
3	F 1 049	(g) 100+growth rate = 107.25%	H 1 049 x 107.25% = 1 125
4	I 1 125	(j) 100+growth rate = 107.25%	K 1 125 x 107.25% = 1 206
5	L 1 206	(m) 100+growth rate = 107.25%	N 1 206 x 107.25% = 1 293

The calculation ultimately shows that should the demand increase by 7.25% each year, the demand will grow from 912 rooms in the current year, to 1 293 rooms over the following five years.

These results indicate an additional demand for 381 (1 293 – 912) rooms.

Question 2. Calculate the future number of rooms required.

In the hotel industry, and depending on the economic climate, an occupancy rate of 60% is regarded as the norm. An occupancy rate in this region means that a hotel will be profitable. From the calculations above it is clear that the average annual occupancy rate for the competitive hotels is 73.79% (table 3.2). With this figure in mind, the current need for additional rooms based on a 60% occupancy rate can be divided by the current nightly demand:

$$808 / 60 \times 100 = 1\ 347$$

From the figures above, it is clear that there is a current shortage of 252 rooms (1 347 – 1 095 = 252). Should a new hotel with 252 rooms be built, the overall occupancy of the region would be

$$808 / 1\ 347 \times 100 = 59.98\%$$

ACTIVITY

Use the information provided in this activity to calculate the future number of rooms required. Also indicate what the average occupancy in the region will then be. Remember to round off your answer.

The norm is an average of 65% occupancy and the average annual occupancy rate for the competitive hotels are 72%. Current demand is 912 rooms. Average nightly demand across competing hotels is 1 105 rooms.

ACTIVITY FEEDBACK

$$912 / 65 \times 100 = 1\ 403$$

$$1403 - 1\ 105 = 298$$

$$912 / 1\ 403 \times 100 = 65\%$$

Should a new hotel with 298 rooms be built, the overall average occupancy would be 65%, which is in line with the norm.

3.8 FINANCIAL ANALYSIS

As an essential component of the overall business plan, the financial feasibility analysis will provide potential investors and financing companies with a calculated overview of the potential profitability of the business venture (Barrows et al 2012; Hassanien et al 2010). For a prospective business this will include features such as capital investment, pro forma income statements (also known as forecasted revenue), projected cash flow and an evaluation of the projections of the financial situation in general (Schmidgall, Hayes & Ninemeier 2002).

Tips

“Feasibility Study Course Lesson 1 - What is a Feasibility Study?”

According to Lahle Wolfe, feasibility studies are very important since the information one collects and portrays in the feasibility study will guide one to:

1. Identify everything one needs to make the hospitality operation work.
2. Recognize logistical and other business-related challenges and opportunities.
3. Establish business and marketing strategies to obtain investment from a bank or investor.
4. Act as the basis for establishing a business plan.

<http://womeninbusiness.about.com/od/businessplans/a/feasibilitystud.htm>

The following is a basic financial feasibility analysis, based on a three-star hotel with 120 rooms.

- Capital investment required and a financial plan.

The estimated costing for a three-star city hotel in an upmarket suburb can be projected as follows.

Table 3.5: Capital investment requirements

	R
Land	3 000 000
Building	9 500 000
Furniture and fittings	1 500 000
Interest on construction financing	1 000 000
Initial working capital	1 000 000
Sundries	750 000
Total	16 750 000

The estimated total investment for the hotel is R16,75 million and is outlined in the following **financial plan**:

The total investment funding will also be calculated in terms of the debt to equity ratio.

Note: Remember that these figures are not realistic in today's terms.

According to Hassanien et al (2010), debt capital is mainly funded by the banks, while equity capital is often sourced from private funding from the owner/investor.

Here is an example of a simple calculation of the debt:equity ratio applied.

Table 3.6: Debt: equity ratio of total financing requirements

	Debt (63.13%)	Equity (36.87%)	Total
Total	10 575 000	6 175 000	16 750 000

ACTIVITY

Complete the financial plan for the following hotel, using the information provided.

Capital investment requirements:

	R
Land	2 500 000
Building	10 500 000
Furniture and fittings	1 800 000
Interest on construction financing	1 400 000
Initial working capital	1 750 000
Sundries	950 000
Total	18 900 000

Calculate the debt:equity ratio for each of the financing items:

	Debt	Equity	Total
Land and building (65% debt, 35% equity)	A	B	13 000 000
Furniture and fittings (65% debt, 35% equity)	C	D	1 800 000
Interest on construction financing		1 400 000	1 400 000
Initial working capital		E 750 000	F 750 000
Sundries			
Total	G	H	I

ACTIVITY FEEDBACK			
	Debt	Equity	Total
Land and building (65% debt, 35% equity)	A $(13\,000\,000 \times 65\% = 8\,450\,000)$	B $(13\,000\,000 \times 35\% = 4\,550\,000)$	13 000 000
Furniture and fittings (65% debt, 35% equity)	C $(1\,800\,000 \times 65\% = 1\,170\,000)$	D $(1\,800\,000 \times 35\% = 630\,000)$	1 800 000
Interest on construction financing		1 400 000	1 400 000
Initial working capital		E 1 750 000	F 1 750 000
Sundries		750 000	750 000
Total	G $8\,450\,000 + 1\,170\,000 = 9\,620\,000$	H $4\,550\,000 + 630\,000 + 1\,400\,000 + 1\,750\,000 + 750\,000 = 9\,080\,000$	I 18 700 000

Hospitality projects can draw on financing from the following sources (Hassanien et al 2010):

- private sector (e.g. banks, venture capital, owners/investors equity)
- public sector e.g. government grants for economic/business development (e.g. DTI grants), local government investment
- voluntary sector
- e.g. conservation funding, educational trusts

The project in our example may therefore be financed in the following ways:

- **Mortgage bond from bank A**

The mortgage bond taken on the land and buildings (R12,5 million), negotiated at an interest rate of 10% over a period of 20 years, and with a repayment amount of R1,5 million per annum, can be calculated as follows over a five-year period.

Table 3.7: Mortgage bond and repayments

Year	Annual repayment	Interest	Capital	Balance
				12 500 000
1	1 500 000	1 250 000	250 000	12 250 000
2	1 500 000	1 225 000	275 000	11 975 000
3	1 500 000	1 197 500	302 500	11 672 500
4	1 500 000	1 167 250	332 750	11 339 750
5	1 500 000	1 133 975	336 025	11 033 725

These figures can be divided by 12 to calculate the amount to be paid each month on capital and on interest:

Year 1 repayments on capital are $R250\,000 \div 12 = R20\,833.33$ per month.

ACTIVITY

1. Log on to the website of any well-known South African bank.
2. Search for the section on business loans.
3. Use the finance calculator provided on the website. Enter an amount for which you would want a business loan and calculate the repayments using an interest rate of 11.5%.
4. Then enter a higher interest rate of 13%. Can you see how the repayment changes?

ACTIVITY FEEDBACK

By using the financial calculator on the bank's website, you will see what the repayments on the loan amount would be. This will give you a good idea of whether or not your business can afford the loan amount. Changing the period of the loan (e.g. from 20 years to 15 years) may also reduce the amount of interest paid on the loan).

Ultimately, businesses wanting to apply for loans from financial institutions need to check whether they can afford the repayments of the loan, based on projected income.

- **A loan from Bank B to finance furniture and fittings.**

The furniture and fittings (R1,5 million) may be financed by means of a short-term loan (five years) from an alternative bank. This loan would be calculated at an interest rate of 15%, which would result in an annual repayment of R280 000.

The calculations for the five-year period are as follows.

Table 3.8: Furniture and fittings repayments/short-term loan

Year	Annual repayment	Interest	Capital	Balance
				1 500 000
1	450 000	225 000	225 000	1 275 000
2	450 000	191 250	258 750	1 016 250
3	450 000	152 437,50	297 562,50	718 687,50
4	450 000	107 803,13	342 196,87	376 490,63
5	320 017,04	56 473,59	320 017,04	0,00

This set of calculations shows how the debt for R1 500 000 for furniture and fittings can be settled over a period of five years. Depending on the financial risk involved, banks will negotiate the interest rates and repayment terms to suit the individual operator's needs.

- **Pro forma income statement/forecasted revenue**

The pro forma income statement/forecasted revenue shows the revenue which is expected to be generated by different departments in the hotel.

For the purpose of this example, we have only indicated two departments: rooms, and food and beverage.

Rooms

The revenue expected to be generated from rooms revenue is based on the assumption that the occupancy rate will be 60% in year 1, at an average rate (income derived from rooms divided by the number of rooms sold) of R750.

The competitive rate in the area will be utilised for years 2 to 5. The average room rate will increase by 10%, but is dependent on market movements.

The rooms revenue for years 1 and 2 is as follows:

- Year 1
120 rooms x 60% x R750 x 365 days in the year = R19 710 000
- Year 2
(based on a 10% increase in average room rate, with sustained occupancies)
R750 + 10% = R825
120 rooms x 60% x R825 x 365 days in the year = R21 681 000

The operating expenses for rooms can be estimated at

- Year 1

Payroll (20% of turnover)	R3 942 000
Other direct expenses	R1 750 000
Total	R5 692 000
- Year 2

Payroll (20% of turnover)	R4 336 200
Other direct expenses	R1 725 000
Total	R6 061 200

The estimated operating income for rooms for years 1 and 2 is as follows.

Table 3.9: Estimated operating income for rooms division

	Year 1 (R)	Year 2 (R)
Rooms revenue	19 710 000	21 681 000
Operating expenses	5 692 000	6 061 200
= operating income	15 219 800	15 619 800

Food and beverage

The hotel operates one restaurant that can seat 150 covers at one sitting. The restaurant only serves breakfast and dinner. The restaurant operates seven days a week. The price of the average cover and the price per sitting are as follows:

Breakfast: 120 covers @ R95,00 per person

Dinner: 135 covers @ R150,00 per person

The restaurant operates on a markup of 200%. The projected income from the restaurant is as follows.

Table 3.10: Projected restaurant income

	R
Revenue (projected annual)	
Breakfast (120 x 95,00 x 365 days)	4 161 000
Dinner (135 x 150,00 x 365 days)	7 391 250
Total projected revenue	11 552 250

Cost of sales:	
<i>Cost price (CP) = 100 = 33.3%</i>	3 846 899,25
<i>Sales price (SP) = 300 = 66.7%</i>	
Gross profit (66.7%)	7 705 350,75

The total expected revenue before expenses for the year can therefore be calculated as

	Year 1 (R)
Rooms revenue (table 3.8)	15 219 800
Food & beverage revenue (table 3.9)	7 705 350,75
Total revenue before expenses	22 925 150, 75

We will discuss food and beverage revenues in more detail in a later learning unit.

Projected cash flow

The hotel's projected cash flow for the next five years can be calculated based on the revenue and operating expenses for rooms, and on revenue and operating expenses for food and beverage. Other operational expenses, such as administrative expenses, depreciation and income tax, must also be taken into consideration. This projection will be done for the next five years and will take into consideration an increase in revenues of 10% per annum, while maintaining market share and occupancies.

3.9 CONCLUSION

This learning unit has provided you with guidelines on how to approach your own hospitality business, and also with sound strategies for building on an existing business.

The importance of a hospitality operation's location, its access to its target market and various factors were highlighted. The marketability of the business within a certain market segment is given due consideration as well as guidelines on building the market and expanding the business.

The importance of a feasibility study, an in-depth analysis of the financial feasibility of a hospitality operation or a new property development, was also discussed with practical examples. A feasibility study cannot guarantee financial success, but it does reduce much of the risk and guesswork involved in a new venture, and allows the future hospitality operator to evaluate the potential success of the business (Hassanien et al 2010).

This learning unit therefore provides you with a structured and calculated guideline which hospitality operators can follow in their quest for business success.

3.10 KEY TERMS

Business development

Business plan

Business strategy

Entrepreneurship

Entrepreneur

Differentiation

Feasibility study

(Market) segmentation

Withdrawal

Location

Supply and demand analysis

Composite growth

Financial analysis

Average occupancy

Cash flow

3.11 SELF-ASSESSMENT QUESTIONS

1. You are the owner of a small take-away shop on the main road leading to the local taxi rank. Your menu consists mainly of toasted sandwiches, burgers and a small range of cold drinks. Use clear examples of how you would apply the four main business development strategies to your business in order to grow revenue.
2. Review the key considerations for starting a business.
3. Analyse the three critical questions associated with the strategic management of a business. Apply each of the questions to the example of the business used in the scenario in question 1.
4. A sound business strategy would guide the business in reaching its goals. Which issues would need to be tackled by the business strategy?
5. Define the concept “entrepreneurship”.
6. Clarify the concept of a “business plan” and provide a broad guideline of the sections included in a business plan and the topics which should be covered under each section.
7. Analyse the location of the business as a strategic imperative to business success. (Use the example provided in the scenario in question 1.)
8. The landlord of the premises where your take-away business is located has sold the building and you are forced to move to another location which is not on the main route. Analyse the potential impact of this on your business in relation to:
 - a) access to customers/target market
 - b) access to suitable suppliers
 - c) availability of public facilities
9. Define a “feasibility study” and discuss its key objectives.

Note: Activities where calculations were required in this learning unit may be incorporated into assessment questions.

10. Use the information provided to complete the table with the relevant calculations. You must provide answers for letters (A) to (K):

Current average room rate is R850 with an annual increase of 5%, and occupancy will be 70%.

The operating expenses for rooms can be estimated at

Year 1

Payroll (15% of turnover)	R (A)
Other direct expenses	R1 125 000
Total	R (B)

The restaurant operates on a 300% markup. The projected income from the restaurant is as follows:

	Rand
Revenue (projected annual)	
Breakfast (120 x 115,00 x 365 days)	(C)
Dinner (145 x 149,00 x 365 days)	(D)
Total projected revenue	(E)
Cost of sales	
<i>Cost price (CP) = 100 = 25%</i>	(F)
<i>Sales price (SP) = 400 = (f)%</i>	
Gross profit (G)	(H)

The total expected revenue before expenses for the year can therefore be calculated as

	Year 1 (Rand)
Rooms revenue	(I)
Food & beverage revenue	(J)
Total revenue before expenses	(K)

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