case | 22 The Kimpton Hotel and Restaurant Group

Armand Gilinsky Jr.
Sonoma State University

Richard L. McCline
San Francisco State University

> When your strategy is deep and far reaching, then what you gain by your calculations is much, so you can win before you even fight. When your strategic thinking is shallow and nearsighted, then what you gain by your calculations is little, so you lose before you do battle. Therefore it is said that victorious warriors win first and then go to war, while defeated warriors go to war first and then seek to win.
>
> —Sun Tzu, "The Art of War"

At 8:30 AM on June 3, 1999, Steve Marx, vice president of hotels for the Kimpton Hotel and Restaurant Group, Inc., left the office of Thomas La Tour, president of Kimpton. The hour-long breakfast meeting in the company's San Francisco headquarters had been bittersweet. On the previous day, Marx had accepted an "irresistible" offer from Jonathan Tisch, president of Loews Hotels, to manage its hotel operations based in New York City. Marx had wrestled with the decision but recognized that, professionally, he almost *had* to accept the offer from Loews. La Tour understood the dilemma and, with regret, accepted Marx's resignation and two-week notice. The two men anticipated a continuation of the friendship that had characterized their relationship from the beginning. The personal aspect of the decision was as difficult for Marx as the professional component had been. He, his wife, and their 10-year-old son loved living in the San Francisco Bay area and were not thrilled about the prospect of relocating to the New York metropolitan area.

Over the past six years, Marx and La Tour had built the ninth largest hotel management company in the United States, with groupwide revenues per available room (RevPAR) approaching $125 per night and occupancy rates an estimated 85 percent, placing it in the top tier of all U.S. hotel management companies. (RevPAR is a key industry benchmark that really indicates how one makes money in the hotel industry.) Since is formation in 1981, Kimpton Group (KG) had, by 1999, grown into a $250 million hotel company with 5,308 rooms and 5,325 employees, among which 40 staff

This case was presented at the 1999 meeting of the North American Case Research Association in Santa Rosa, CA.

managed its hotel division alone. In early 1998, La Tour had said publicly that he expected the growth pattern of opening three new hotel properties a year to continue "indefinitely." Whereas seed investment capital had originally come from some 200 loyal investors contributing $100,000 apiece, more recently a partnership with the Crow family in Texas provided a $300 million development fund to acquire new hotel properties. The company was privately held.

At 51 and now in his 26th year in the industry, Marx had previously worked his way up at Hilton to become a manager of several hotels. He then left Hilton in the late 1980s for London to manage Trusthouse Forte's hotel properties in the United Kingdom. Just before their son was born, Marx and his wife relocated to Monterey, California, where he managed a Doubletree hotel for three years before being headhunted by KG in 1992.

Prior to his 3:00 PM, June 3, 1999 meeting with his two senior direct reports, David Martin, director of operations, and Jeff Senior, vice president of hotel sales and marketing, Marx reflected on the several key strategic issues that he thought the senior management team would need to address in the near future. Among the strategic choices that he thought would require attention were (1) determining the feasibility of acquiring new properties in new markets on the East Coast and in the South; (2) evaluating the near-term potential to gain additional revenue by developing and adding new services such as Internet connectivity and related products; and (3) the pros and cons of developing product branding to increase market identification, using perhaps the Hotel Monaco as the flagship brand. Additionally, Marx would encourage the senior managers to consider how much longer Kimpton could continue to capitalize on the benefits of the rapidly closing "window" in the real estate market. Historically, Kimpton has prospered by purchasing and renovating buildings at a discount in strategic nationwide locations that matched Kimpton's niche segment. Aggressive national growth could potentially create a strong base of resources and core competencies to support an eventual long-term growth strategy of diversification and globalization. In the short term, maybe some forms of valued-added services could be added to the marketing mix to win the battle for more discriminating customers in a highly competitive marketplace. The hotel industry in general had been slow to enter the boutique niche, and Kimpton currently enjoyed a substantial edge in experience in developing value-added services for guests. Another potential strategic choice could have the Kimpton team focus on the individual brand equity of each hotel and embrace the entry of new boutique competitors into the competitive set, since they would help create and grow the category, in essence giving the "boutique category" the credibility necessary to generate long-term profitability and growth.

Marx would caution Senior and Martin that any future strategy would have to be guided by founder Bill Kimpton's original formula for acquiring undervalued assets:

> We are proud of our value engineering, construction, and design. We make very few mistakes. Kimpton doesn't build hotels from the ground up. We buy buildings and renovate them, primarily undervalued assets in downtown, urban locations. We try to outperform other hotels in our particular segment and create value for our owners.

Equally important, Marx would remind his executive team, is that the important strategic decisions that must be made must also uphold the company's mission of "getting and keeping guests, keeping and developing employees." He felt personally responsible for having developed an organization and management style to attract professional managers from other hotel chains to Kimpton. Martin and Senior were part of his recruited talent and would be expected to take increasingly more highly visible roles in determining the company's destiny after Marx's departure.

As the meeting began, Marx reflected on the Kimpton Group's rapid growth and strategic positioning within the hotel industry:

> Five or six years ago we made a conscious decision to grow. Life is growth; you can't ever stay where you are. Our investors see us as the future of the industry, as we have created a category and become a dominant player in that category. We offer personal, intimate service to our guests, people who live in an increasingly impersonal world. We provide five-star service at a four-star price. We need to become the most unique "four-diamond" hotel in each market we serve. That's our niche, and we welcome imitators because they validate what we're doing.

Since Marx joined the company, KG had grown from 14 hotels and restaurants in San Francisco to 23 boutique hotels and 24 upscale and popular restaurants in major cities such as San Francisco, Portland, Seattle/Tacoma, Chicago, Denver, and Salt Lake City. Two new properties, Serrano Hotel and Hotel Palomar, were scheduled to be opened in San Francisco in summer 1999. A list of KG's leading hotel and restaurant properties is provided in Exhibit 1.

THE U.S. HOTEL INDUSTRY

Global issues, changing industry fundamentals, increasing volatility in the capital markets, and a general unease with the direction of the economy created opportunities for Kimpton to aggressively expand nationally while its competitors were scrambling to refocus. For hotels, managing supply and demand was a top priority for decision makers. Since the hotel industry's recovery from the recession of the early 1990s, it had changed from the fragmented, high-growth state that dominated the 1980s to the fierce competitive environment of the late 1990s. As the industry approached the millennium, demand for hotel rooms increased by 3.1 percent in 1997–98 over 2.5 percent in 1996–97, while RevPARs also grew by 5.3 percent and 3.5 percent, respectively, according to Smith Travel Research. Exhibit 2 provides a summary of the generally upward trends of occupancy rates and RevPARs for the 1994–98 period. Exhibit 3 provides time series data on occupancy and average daily revenue trends in the U.S. lodging industry.

The American Hotel and Motel Association had forecast that both business and tourist travel would increase during the early 21st century, and that more than 1 billion people would be traveling worldwide by 2006, when international tourism dollars were projected to total more than $7.1 trillion. The United States would continue to be the first choice for tourists, attracting almost 50 million for 1999 alone. Employment was also expected to rise, with estimates of 1.89 million people working in the tourism industry by 2005, according to the U.S. Department of Commerce's *1998 Census of Service Industries.*

KG's competition in the full-service hotel segment included many well-known brand names such as Hilton, Hyatt, Marriott, Promus (Doubletree), and Starwood (Sheraton and Westin brands). For the year ending December 1998, revenues rose at Hilton by 35 percent, Promus by 25 percent, and Marriott by 20 percent. In 1998 RevPARs at these hotels demonstrated the continued strong recovery of the industry from the recession of the early 1990s, rising by 8 percent at Hilton, 6 percent at Promus, and 6 percent at Marriott. This upsurge in business made its way to the bottom line. Hilton's earnings before taxes and other nonoperating income rose by 75 percent; Promus's corresponding earnings rose 25 percent and Marriott's by 18 percent, according to *Moody's Industry Review* on January 22, 1999. Operating profit margins for some of the more profitable companies reached a high of 35 percent in 1997, according to *Moody's.* Selected 1998 operating results for the top 10 publicly traded U.S. hotel

exhibit 1 Kimpton Group Hotels and Restaurants as of June 1999

	Date Opened	Number of Rooms	Number of Seats
San Francisco			
Clarion Bedford Hotel at Union Square	April 1981	144	—
Hotel Vintage Court/Masa's	April 1983	107	100
Galleria Park Hotel/Perry's Downtown	June 1984	177	133
Juliana Hotel	September 1985	106	—
Villa Florence Hotel/Kuleto's Italian Restaurant	May 1986	180	176
Monticello Inn	October 1987	91	—
Puccini & Pinetti	June 1995	—	160
Prescott Hotel/Postrio	April 1989	158	150
Carlton Hotel	June 1989	165	—
Splendido	November 1989	—	150
Cartwright Hotel	January 1990	114	—
Tuscan Inn/Café Pescatore	July 1990	221	—
Harbor Court Hotel/Harry Denton's	April 1991	131	176
Hotel Triton	October 1991	140	—
Kuleto's Trattoria	September 1993	—	200
Sir Francis Drake Hotel	April 1994	417	—
Scala's Bistro	January 1995	—	200
Hotel Monaco/Grand Café	June 1995	201	260
Serrano Hotel	June 1999	236	—
Hotel Palomar/Fifth Floor	August 1999	198	75
Portland			
Hotel Vintage Plaza/Pazzo Ristorante	May 1992	107	200
Fifth Avenue Suites Hotel/ Red Star Tavern & Roast House	May 1996	221	200
Seattle/Tacoma			
Alexis Hotel	September 1982	109	—
The Painted Table	May 1992	—	100
Hotel Vintage Park/Tulio	August 1992	127	156
Hotel Monaco Seattle/Sazerac	August 1997	189	185
Sheraton Tacoma Hotel/Broadway Grill	May 1984	319	170
Chicago			
Hotel Allegro/312 Chicago	March 1998	489	244
Hotel Monaco Chicago/Mossant	November 1998	193	174
Denver			
Hotel Monaco Denver/Panzano	October 1998	189	244
Salt Lake City			
Hotel Monaco Salt Lake	July 1999	—	—

Source: The Kimpton Group.

corporations are presented in Exhibits 4 and 5. A brief overview of the strategies and competitive tactics of the three largest competitors is shown in Exhibit 6.

Some industry observers commented that the hotel industry's outlook remained uncertain. Joseph Tardiff, an analyst writing in *U.S. Industry Profiles, 1998,* reported that across the nation, room supply grew by about 4 percent in 1998 after 3.5 percent growth in 1997. In the July 1998 edition of *Lodging,* a leading industry trade publication, Smith

exhibit 2 U.S. Lodging Industry Supply and Demand, 1994–98

% Change in Supply					% Change in Demand				
1994	1995	1996	1997	1998	1994	1995	1996	1997	1998
1.0	1.5	2.8	3.4	4.0	3.0	1.7	2.3	2.5	3.1

Sources: Bear Stearns & Co., Smith Travel Associates Research, Coopers & Lybrand LLP.

exhibit 3 U.S. Lodging Industry Occupancy and Average Daily Rates, 1991–99

	1991	1992	1993	1994	1995	1996	1997	1998	1999 (1st quarter)
Occupancy %	61.8	62.6	63.5	64.7	65.0	65.1	64.5	64.0	59.4
% change	(1.7)	0.8	0.9	1.2	0.3	0.1	(0.6)	(0.5)	(4.6)
Average daily rate	$58.10	$58.90	$60.50	$62.80	$65.80	$69.90	$75.20	$78.60	$81.90
% change	0.2	1.4	2.8	3.8	4.7	6.2	5.3	3.5	3.3

Sources: Bear Stearns & Co., Smith Travel Associates Research, Coopers & Lybrand LLP.

exhibit 4 U. S. Lodging Industry Rankings by Revenues, Fiscal Year 1998 ($ Millions)

Company Name	Latest Revenues
Sodexno Marriott Services, Inc.	$12,034
Hilton Hotels Corporation	5,316
Starwood Hotels & Resorts	4,700
Trump Hotels and Casino Resorts	1,399
Host Marriott Corporation	1,147
Promus Hotel Corporation	1,038
MGM Grand, Inc.	828
Red Roof Inns, Inc.	351
Prime Hospitality Corporation	341
Sunterra Corporation	338

Source: "Hotels and Motels," *Moody's Industry Review,* January 22, 1999.

Travel Research forecast that demand growth would average 2.4 percent through the year 2000. Analysts also cautioned that room supply growth would average 3.2 percent, raising fears of oversupply, declines in occupancy rates, and probable diminution of growth rates in RevPAR as well as industrywide profitability. Industrywide profits had risen by 20.5 percent from 1997 to a record $17.6 billion in 1998, and were forecast by Smith Travel Research to increase to $19.2 billion in 1999 and $21 billion in 2000, respectively. To partially offset the prospect of oversupply in the industry, some hotel companies (e.g., Marriott) were said to be pursuing diversification into retirement facilities and time-share programs, according to Bill Scatchard, publisher of *Hoteliers' Infosource.*

exhibit 5 Financial Ratio Data for Top 10 Hotel Chains (Ranked by Fiscal Year 1998 Revenues)

Company Name	Return on Capital	Return on Assets	Current Ratio	Operating Profit Margin	$ Revenues per Employee
Sodexno Marriott, Inc.	10.13%	5.30%	.88	6.03%	$61,713
Hilton Hotels Corporation	3.73	3.19	1.07	11.21	87.147
Starwood Hotels & Resorts	12.40	7.70	.50	7.62	36,154
Trump Hotels	nmf	nmf	1.55	10.23	12,580
Host Marriott Corporation	0.80	0.72	10.43	35.05	n/a
Promus Hotel Corporation	4.52	4.01	.55	17.72	25,317
MGM Grand, Inc.	9.47	8.24	.94	23.08	126,219
Red Roof Inns, Inc.	2.91	13.15	.71	25.05	60,517
Prime Hospitality Corporation	2.36	2.16	.76	26.64	50,147
Sunterra Corporation	3.23	2.83	4.67	15.89	81,445
Marcus Corporation	5.32	4.68	.43	17.16	48,000
Industry averages	4.00%	5.90%	1.00	2.99%	$62,343

nmf = not meaningful figure
n/a = not available
Source: "Hotels and Motels," *Moody's Industry Review,* January 22, 1999.

exhibit 6 Major Lodging Companies' Strategies

Marriott

- Price segmentation
- Customer segmentation
- Global presence
- Time-share segments
- Senior care—bought senior living Forum Group, now largest operators of senior housing
- Brand management
- Selling non-industry-related businesses
- Selling hotels that do not match strategy
- Acquisitions in midpriced segment
- Acquisition of small hotel companies

Hilton

- Price segmentation
- Customer segmentation
- Global presence
- All-suites segment
- Gaming—now industry leader in facilities
- Brand management
- Acquisition of full-service hotels
- Global expansion in midpriced segment
- Electronic marketplace
- Employee training in quality improvement

Promus

- Price segmentation
- Customer segmentation
- Global presence
- Time-share segments
- All-suites segments
- Merger with other large hotel leader
- Brand management
- Partnership with food producer (Dole)
- Sponsorship of sporting events
- Restructuring of management in early 1999

Sources: www.mariott.com, www.hilton.com, www.prnewswire.com, May 12, 1999.

Ted Mandigo, an industry observer quoted in *Hotel & Motel Management,* felt that location was the key to success: "Finding a good location in a commercial district is an excellent way to enter a market. Many such opportunities have already been exploited. The operator looking for undervalued assets that can be turned into boutique hotels will

exhibit 7 Hotel Industry Growth, 1990–98

Year	Number of Hotels	% Growth	Number of Rooms	% Growth
1990	30,114		3,206,454	
1991	30,384	0.9%	3,234,673	0.8%
1992	30,516	0.4	3,249,699	0.5
1993	30,727	0.7	3,270,864	0.6
1994	31,152	1.4	3,306,304	1.1
1995	31,808	2.1	3,354,970	1.5
1996	32,851	3.3	3,455,087	2.9
1997	34,225	4.2	3,588,072	3.8
1998	35,013	2.3	3,662,524	2.1

Source: Smith Travel Associates Research.

need a sharp pencil to avoid buying bargain properties that do not create a situation of oversupply." Other critical success factors appeared to determine a firm's ability to remain competitive in the hotel industry. At the basic level, hotel owners strove to create a level of service that attracted and retained customers. The "experience" of staying at a particular hotel facility was intended to have a lasting and memorable effect if a hotel was to be distinguished from the competition.

The trend, noted in the *1994 Atlas of the American Economy,* toward hotel property and management consolidation, posed several threats for owners of small and midsized hotel chains. As the larger firms continued to grow and expand their operations, it became easy to expand beyond economies of scale factors and create an oversupply, driving down room rates. This threat was heightened during economic downturns and could significantly affect both the overall occupancy rate in the industry and profitability. In the early 1990s there was a notable and steady increase in the number of establishments, according to Smith Travel Associates (see Exhibit 7). The result was a surplus of rooms and low occupancy rates. High operating expenses diminished profit margins considerably in years with low occupancy rates, especially given that hotels had to keep room rates down in such years as well. The predictable outcome was that record losses were experienced by the industry during a period of oversupply (e.g., full-service hotels with significant departmental expenses particularly experienced this loss history). The occupancy rates for limited-service hotels were not significantly different from those of full-service hotels, according to Smith Travel Associates. This suggests why some large corporate hotel operators in the late 1990s were emphasizing a more limited-service facility that had lower operating costs yet retained good customer traffic and operating gross margins. Exhibit 8 presents 1995 data on hotel real estate selling prices and estimated costs of replacement per room.

Perhaps the most profound change in hotel industry strategy arose from the dramatic shift of hotel properties from private to public ownership. The volume of investment dollars for the hotel industry was significantly greater in the late 1990s than it had been historically. Banks, insurance companies, finance companies, equity investors and real estate investment trusts (REITs) entered the hotel industry with aggressive parameters as they perceived that the market oversupply had begun to dissipate. The latter instrument, REITs, which emerged in 1991, had become a major source of low-cost capital that fueled growth and construction in the hotel industry. Starwood Lodging had used REITs as a vehicle to acquire Westin Hotels and Sheraton Hotels from IT&T. The availability of low-cost capital became an especially important factor for the larger players in the industry, who moved increasingly toward consolidation via acquisition

exhibit 8 Hotel Real Estate Selling Prices and Estimated Costs of Replacement, 1995

Lodging Segment	Average Selling Price per Room	Estimated Cost of Replacement per Room
Budget	$11,804	$25,000–30,000
Economy—limited service	20,538	30,000–35,000
Economy—full service	19,239	35,000–50,000
Midmarket—limited service	42,244	35,000–50,000
Midmarket —full service	42,117	45,000–70,000
Luxury—limited service	65,174	80,000–150,000

Source: National Hotel Realty Advisor.

of other chains, according the Smith Travel Associates. However, the lowering of barriers to entry allowed disproportionate levels of new supply in the industry.

Aging of the baby boomers also emerged as a significant demographic factor. Seventy million Americans were moving into their midlives (over 50) and were expected to seek greater comfort and choose service over price in their choice of hotels. In the late 1990s, other emerging trends in the hotel industry included (1) the introduction of limited-service suites; (2) additional emphasis on higher-value-added business-related amenities such as data ports for laptops and interactive Web TV sets in rooms; (3) automation of labor-intensive functions via information technology; (4) development of extended-stay or "residence-style" hotels and time-share projects; (5) reduction in marketing expenses and long-term operating costs via standardization and branding of properties.

In spite of the many changes in the hotel industry, comments made by Kimpton executives suggest that, in addition to location, the factors still considered critical to success in the hotel industry include:

- Low-cost purchases of land or buildings.
- Greater latitude in product/service offerings at comparable profit margins.
- Customer service.
- Effective utilization of technology.
- Brand loyalty.
- Employee training and development.
- Complementary services.
- Revenue management systems.
- Clean and comfortable lodging.
- Strategic alliances.
- Convenience in making reservations.
- Access to growth capital.
- Value-added services.

The Boutique Hotel Niche

As the millennium approached, the emerging boutique or small luxury hotel niche began attracting new entrants, both large and small. For example, Starwood Hotels & Resorts announced in late 1998 that it was launching a new "W" line of boutique hotels with fewer than 400 rooms in an attempt to replicate the Kimpton formula for success.

Based in White Plains, New York, Starwood Hotels & Resorts managed, owned, and operated such branded properties as St. Regis and the Luxury Collection (luxury hotels), Westin (upscale full-service), Sheraton (full-service), and W (boutique full-service hotels for business travelers). It had sold its Caesars World properties in early 1999. Starwood's meteoric yet troubled rise had been guided by chairman Barry Sternlicht (German for "starlight"), an aggressive dealmaker who snatched ITT from Hilton Hotels. Sternlicht owned about 5 percent of the firm. In 1999 the company abandoned its paired-share real estate investment trust structure for a standard corporate structure with a property-owning REIT subsidiary; Starwood Hotels & Resorts Worldwide managed the operation of the properties. A 21-story W Hotel opened across from the Moscone Convention Center in San Francisco in April 1999. Despite heavy debt and the high costs of integrating operations acquired during the whirlwind buying spree that preceded the change in its structure, in mid-1999 Starwood announced that it planned to expand into Latin America.

The other national player in the boutique hotel category, according to a July 1999 story in the *San Francisco Examiner,* was New York hotelier Ian Schrager (formerly co-owner of the Studio 54 disco). Schrager ran the Royalton in New York, the Mondrian in Los Angeles, and had purchased the Clift Hotel in San Francisco for $80 million in June 1999. The Clift was undergoing a $25 million facelift prior to its reopening in October 1999.

Boutique hotels accounted for about 15 percent of San Francisco's estimated 31,000 rooms. In San Francisco, KG was the recognized market leader, with 67 percent of the city's boutique hotels, according to analyst Anwar Elgonomy of PKF Consulting. Chip Conley's Joie de Vivre Hotels enjoyed 20 percent of the San Francisco market, and Yvonne Lembi-Detert's Personality Hotels on Union Square, with four properties, had 12 percent of the market. Other operators split the remaining 1 percent. "It's a very specific group of people [boutique hoteliers] are going after: well-educated professionals," Elgonomy said recently in an interview in the *San Francisco Examiner,* "people who don't like generic activities. People who don't like Starbucks."

Chip Conley, president of Joie de Vivre, a $40 million chain of 14 boutique hotels and motels in the San Francisco Bay area, commented on the boutique lodging niche in an April 1999 interview with Neal Templin in the *Contra Costa Times*:

> The question is whether the big boys will have the agility to handle the boutique market. We look for aging hotels with "good bones"—good elevators, plumbing and electrical systems—and bad images. We spend our money on things that get a lot of bang for the buck. Our strategy is to make our Hotel del Sol a national brand by buying a portfolio of motels around the country and converting them to the same concept. There's a huge collection of 1950s and 1960s hotels waiting to be fixed up. Our next project to open will be a boutique camping resort south of San Francisco where guests will rough it in tents but still be able to order up caffé lattés after their hikes in the woods. It is aimed at the sort of people who buy sport-utility vehicles even though they rarely drive off-road. They can feel like they're connected with nature while not getting their hands dirty.

One reason San Francisco spawned so many boutique hotels is that it had had a big inventory of older hotels that could be cheaply acquired and converted. Analyst C. Jay Scott, of Scott Hospitality Services in San Francisco, noted, "Boutique hotels don't work everywhere. They work only in downtowns that are still vibrant relative to business and leisure travel markets. It's a concept that has been well received by the marketplace. Why try to continually reinvent yourself when you have a concept that works?"

As property values in San Francisco soared, KG's competitors were increasingly building all-new developments, which, in the opinion of Kimpton executives, were both more risky and less profitable than conversions. By contrast, most of the KG's hotels were converted buildings that had been built for other purposes. In the words of Jeff Senior, KG's director of marketing:

> Our lowered asset investment requires a lesser average rate to be successful. In other words, it costs us less, so we can charge less and still be as much or more profitable than our competitors. In reality, any full service hotel in markets we compete within is a competitor, including Sheraton, Westin, Hyatt, Starwood, etc. Other competitors include other boutique providers.

According to Bill Scatchard, publisher of *Hoteliers' Infosource,* the baby-boomer generation was attracted to the boutique style hotel that Kimpton Group pioneered. The brightly trimmed decor with a hint of European luxury appeared to capture the taste of this lucrative segment. In general, the market appeared to favor properties that offered a fun atmosphere in an intimate surrounding. One hotel manager at the Kimpton Group suggested that his organization was one of two or three companies that had responded to this boutique hotel niche very well. This general manager, keenly aware of Kimpton's prominence in the San Francisco market, took a more global perspective. He emphasized the relative smallness of the company's presence overall and described the Kimpton Group niche in the hotel industry colorfully: "We're like a pimple on the ass of an elephant."

The Kimpton Organization

The Kimpton Hotel and Restaurant Group consisted of a family of 23 boutique-style hotels and 24 unique and often independently successful restaurants. Its hotels ranged in size from 91 to 483 rooms, and a typical hotel had between 100 and 200 rooms. KG's destination restaurants, each with its own local following, were located in the same buildings as the hotels.

Founder William Kimpton, now 63, bought his first hotel in 1981. Kimpton was born in Kansas City, Missouri, and in his schooldays was hampered by what he now believes was dyslexia. He noted that he did not learn to read until he reached high school. He struggled academically but was encouraged by his family to continue schooling. Kimpton earned a bachelor of science in economics from Northwestern University and was a graduate of the renowned University of Chicago Lab School. Prior to starting the Kimpton Group in 1981, Kimpton served for three and a half years as director and vice president of Lepercq de Neuflize, an international investment banking firm. During his stint at Lepercq, Kimpton participated in negotiating, structuring, and overseeing the projects of Lepercq de Neuflize. Preceding Lepercq, Kimpton was a partner in Shuman, Agnew & Co., Inc., in Belvedere, California, where he was responsible for project finance. Other experiences that helped shape his acumen for project financing included almost four years as a manager with Lehman Brothers (now Shearson–Lehman Brothers American Express, Inc.) in its San Francisco office. This assignment in San Francisco followed his three years as an associate for Lehman Brothers in its Chicago office.

Bill Kimpton's approach to the hotel industry was based on his prior career as an investment banker. Kimpton began his foray into the hotel industry by structuring a highly creative investment strategy for the Helmsley Hotel organization. He worked with Harry Helmsley (now probably best known for the exploits of his controversial wife, Leona Helmsley, the "Queen of Mean") to raise seed money for the $23 million renovation of the New York Palace Hotel. Through that project Kimpton became known for his imaginative approach to raising investment capital. Kimpton also handled the financing for the exclusive Kapalua Bay resort in Maui and brought in the Rockefeller family's RockResorts to manage the property.

Bill Kimpton recalled that he wanted to get into a business "that sells sleep, because sleep has high [profit] margins." He combined his bottom-line focus with a unique feel for offering value and comfort with a "personality" in all the Kimpton Group properties. He imprinted on his hotel and restaurant management team a flair for being different yet profitable. "My theory is, no matter how much money people have to spend on big, fancy hotels, they are intimidated," Kimpton said recently. "The psychology of how you build restaurants and hotels is very important. You put a fireplace in the lobby and create a warm, friendly restaurant and the guest will feel safe."

Bill Kimpton, by 1999, had served as chairman and chief executive of KG since its inception. Although he was by then no longer intimately involved in day-to-day management, Kimpton's entrepreneurial style was still very visible in the organization. His style was very personal, and he practiced a decentralized approach to decision making since the early days of the corporation. Following his entrepreneurial flair, each property emphasized guest room comfort rather than high overhead amenities such as fancy water fountains, ornate lobbies, or excessive brass and glass.

Guest rooms were tastefully decorated in cheerful colors with elegant bedspreads and thick carpeting, perhaps reflecting Bill Kimpton's trademark multicolor sweaters. Each room was meant to feel like a comfortable guest room in a friend's luxury home and was complete with good lighting; a stocked honor bar/refrigerator; and direct-dial phones with extralong cords to reach the bed, the desk, and other parts of the room. Hotel lobbies were furnished with the emphasis on comfort, not on waiting, and each had a cozy fireplace.

KG's strategy was to create each hotel as a stand-alone "personality" that appealed to its own unique customer group. The hotels shared a common upscale theme and appearance but priced the rooms below the full-service hotels such as Marriott or Hilton. A European style was visible in almost every KG property. Kimpton's aggressive expansion in San Francisco made it very difficult for other chains to find low-cost property in commercial locations that could compete on both price and amenities found at the KG properties.

A high degree of personalized service and numerous complementary amenities were also the hallmark of KG's hotels. Some KG hotels were testing a system to provide arriving guests with "desk-less" check-in via use of cellular and digital communications technology. Doormen were equipped with headsets and could escort new guests directly to their rooms without the usual paperwork and waiting around, considered to be some of the most unwelcoming experiences of tired travelers who just want to get into their rooms. Most hotels featured some or all of the following complementary services: limousines to the financial district, wine served in the lobby each evening, continental breakfast, and coffee and tea available throughout the day. Most hotels also offered same-day valet and laundry service, room service and express check-out with on-site parking. According to Kimpton executives, all of these services were provided at room rates that averaged 25 to 30 percent lower than comparable hotels in the same markets. Indicative of the success of KG's strategy was its annual occupancy rates, which averaged 85 percent over the group, compared to the industry average, which hovered between 68 and 75 percent, depending on the geographical market segment served.

Human Resources

Hotel general managers were strongly encouraged to innovate and provide their specific property with a personality that separated it from the other properties in KG's portfolio.

Senior management practiced reciprocal communication and was very reluctant to impose anything other than customer-related service standards on each property.

Nanci Sherman, general manager of the Hotel Monaco in San Francisco, confirmed this approach:

> Most of our general managers have a hotel background, but like me are refugees from patriarchal companies like Hilton, Disney, and Ritz-Carlton. People come to Kimpton because they see there's another way. Why is it that in 200,000 hotels around the world that the staff meet every Tuesday and Friday for two hours but no changes ever take place? We built our business around the 2 percent that rarely occurs, not on the 98 percent that happens regularly. We really want to look good. Very rarely do we (as industry people) want to take risks. Building a group culture starts with who we are as people: giving, teamwork, friendship, and confidence. People who get rewarded and promoted here are team players. But you can't run a highly bureaucratic, top-down management style anymore, even in a conservative industry like the hotel industry. That's a major reason why our staff turnover rate has been 18–21 percent over the past two years, far below the average rate of 50 percent in the industry. Low turnover rates are absolutely essential to us, because the hotels with the lowest turnover rates have the highest financial performance, particularly in the tight labor markets that we are experiencing now.

Each hotel manager and line staff member attended "Kimpton University," a program of in-house classes on front-desk service, housekeeping, finance and record-keeping, and corporate wellness. In keeping with KG's philosophy of the "gracious host," general managers poured wine for guests at the cocktail hour each night. It was on these occasions that feedback on amenities and service was most readily obtained on a firsthand basis. Feedback from guests was systematically gathered via comment cards in guest rooms. Some of its hotels were experimenting with using interactive TV in guest rooms to obtain comments at check-out. The company also had hired Pannell Kerr Foster (PKF), a San Francisco-based consulting firm, to obtain quality control information using "phantom guests." Executives were also considering the use of focus groups to obtain feedback about the efficacy of current and planned future service offerings. KG observed a "sundown rule," in that each general manager must respond to a guest's comments on their stay by the end of the business day.

KG hired people whose "light had been hidden under a bushel," according to Jim McPartlin, general manager of the Prescott Hotel in San Francisco and the citywide manager for KG's San Francisco Hotels. "We encouraged the operating managers to 'be different' and think 'outside of the box,'" said McPartlin. "The incentives are there, as we can earn up to 25 percent bonus on our salaries, paid out quarterly. Our typical wage percentage of sales is about 22 percent, of which 70 percent is 'raw' wages and 30 percent are benefits. We also have a 'Circle of Stars,' an employee luncheon once a month, where employees who are recognized by guests for outstanding service can win prizes in a 'Wheel of Fortune'–type game," he added.

KG did not have a formal organization chart. According to David Martin, the director of hotel operations:

> Perhaps this is because we try to create an entrepreneurial atmosphere. We hire managers who have the guts to make decisions. Internal competition—creativity—that we label as entrepreneurial is healthy, as long as it's in the customer's best interests. We must meet minimum customer standards. There's sort of a Maslow's hierarchy almost. We gotta be clean, personable, and offer quick service.
>
> We offer a "fireside chat" once a quarter, where we put Steve [Marx] on the firing line with the hotel general managers. He gets people to express their needs. We've challenged Steve on many occasions. We talk about real issues that are important to managers.

"Mongoose" Strategy

Since its inception in 1981, KG had followed a so-called mongoose strategy—named after the ferretlike animal that successfully kills poisonous animals by circling them until they tire, at which point it dives in quickly and finishes them off. Before the company successfully bought its Bellevue property, Kimpton bid $10 million and was outbid by investors who paid $15 million, according to the *New York Times* on January 16, 1994. The company watched the property for seven years until it was able to pick up that property from those owners for $5 million. Similarly, the firm bought the Sir Francis Drake property for $19.5 million, although the property had been on the market eight years earlier for $60 million. If a property possessed the three attributes of uniqueness in character, location, and design potential, it became a target for the patient capital of the KG and its co-investors. Each new property was typically financed by 60 percent equity and 40 percent debt, considered low leverage in the hotel industry.

In the San Francisco market, which by 1999 included 15 semiluxury hotels and 16 destination restaurants, KG began with the Bedford Hotel in 1981, which was followed by the Vintage Court, the Galleria Park, the Juliana, and so on until the firm controlled some 2,000 rooms in its home market. As a point of reference, the Hilton, which towered in the skyline of San Francisco, had almost as many rooms as the entire collection of KG properties in that city. Other properties were located in Seattle, Tacoma, Portland, Denver, Chicago, and the soon-to-be-opened Hotel Monaco in Salt Lake City.

By mid-1999, KG was considering expansion to the East Coast and had begun looking at properties in New York, Boston, and Washington, D.C. "It's time to start looking outside the West Coast," Bill Kimpton recently told the *San Francisco Examiner.* "It's difficult to find a building that hasn't already been worked over. We'd love to be in New York. We'd like to be in San Diego. We're going into Vancouver [in spring 2000]."

Customer Targets

The KG avoided targeting the 10 percent of customers who wanted absolute luxury. Nor was it after the backpacking student. Rather, KG had sought to serve the 50 to 60 percent of the market that was looking for "comfort and value." In 1994, Bill Kimpton summarized his approach quite succinctly in the *New York Times*: "We sell sleep, while corporation lodging [full-service hotels] is in the entertainment business because of all the extras it has to offer." Guests at those other hotel facilities paid for the meeting rooms, the ornate lobbies, the fabulous water fountains, the unused restaurants, and other services that most would never use. A hotel, according to KG's philosophy, should relieve a traveler of his or her loneliness. It should make guests feel "warm and cozy," Bill Kimpton told the *Chicago Tribune* in 1998. This vision shaped the organization's approach to the hotel industry in general and to its markets in particular.

In discussing KG's success, Steve Marx spoke of a "customer intimacy" that gave "personality" to each one of its properties. This focus on service details resembled the attention to cost details that characterized the property acquisition process for which KG had become noted.

According to Jeff Senior:

> How do we build brand equity? Classic brand management. We need to rely on the power of the individual hotel brands, a core premise in our niche/boutique hotel segment. We need to focus on the product positioning, ensuring uniqueness and legitimate competitive advantage; product and service delivery consistency with the positioning; distribution focus against the highest-yielding channels for our target; and performance management to ensure desired results are achieved, appropriate corrective action taken, and strategic revisions evaluated in

an ongoing manner. We compete within the deluxe category in urban markets . . . both reflecting much higher barrier to entry.

The target market for KG included both business and tourist travelers who were looking for a unique, intimate, and personal hotel experience. International guests represented about 11 percent of KG's total. The amenities offered by KG properties bordered on luxury but provided each guest with a clearly recognized bargain compared with the upscale chains such as Hilton or Marriott.

Restaurant Operations

Each of the restaurants that KG operated had a separate entrance and a separate identity from its hotel location. The company took pains to avoid having its restaurants perceived as "hotel restaurants." Niki Leondakis, vice president of restaurant operations for KG and six-year veteran of the organization, said that hotel restaurants were the antithesis of what her company did best. "The minute that we become a hotel-restaurant," Leondakis added, "that's death. A hotel-restaurant has a stigma: overpriced [and offering] poor service." KG strove to offer dining patrons a "handcrafted" experience—something that gave character and personality. "[We] want our guests to feel they're getting something they can't get anywhere else," commented Leondakis.

Jeff Senior commented:

> When I came to Kimpton less than a year ago, we were already structured with a separate restaurant division. While the downside is a duplication of resources to support the respective businesses, the upside is a focus on the core competencies of each business and the key drivers of profitability. The result: we have profitable restaurants and profitable hotels.

Following this strategy, each KG restaurant was custom-made for each property and market location. Each restaurant was allowed to run independently and to exist with renowned chefs including Julian Serrano (at Masa's), Wolfgang Puck (at the Postrio), and Gionvanni Perticone (at the Splendido). According to KG's San Francisco city manager Jim McPartlin, "We create freestanding restaurants that actually make an operating profit, around 5 to 15 percent versus the break-even margins at typical hotel restaurants."

Each of the KG-managed restaurants was individually themed and offered a variety of food styles, price ranges, and ambiences. Many of the restaurants featured exhibition kitchens and counter seating that made them user-friendly for single guests who wished to dine alone. "Our restaurants are run by restaurateurs," said Leondakis. "We provide service to the hotel, but our restaurants are more than a food and beverage outlet. We are a profitable, independent, and separate business."

In December 1998, a Smith Travel Associates report on the U.S. lodging industry noted that, on average, 73 percent of a hotel's revenue came from rooms, 20.6 percent from food and beverage, and 6.4 percent from minor operations such as telecommunications, space rentals, and other miscellaneous sources. KG depended on its restaurants to deliver extra perceived value to customers, much as the full-service hotel with much higher room rates would. The most obvious cross-marketing between the restaurant and hotel operations occurred when restaurant customers visited the restroom and inevitably had to walk through the lobby of the hotel. Diners would, hopefully, spread the word about the little boutique hotel that they had "discovered" while having a terrific dinner.

Thus, KG helped pioneer the strategy of a stand-alone restaurant as a lure to get word-of-mouth advertising for its hotels. However, other chains, such as Fairfield Inns by Marriott, Hilton Garden Inn, and Microtel were known to be operating some of their properties under a strategy very similar to the Kimpton Group's approach of attracting travelers by being closely associated with a world-class restaurant. A potential concern for all using this strategy is that there is a limited pool of quality chefs willing to work within the structure of a corporation, especially when the strong suit of the corporation is the hotel division.

The Future

As with most business situations, past success could turn out to be a double-edged sword for KG. A recent collaboration with the Trammel-Crow investment group made funds more or less readily available for property acquisition and rapid growth. Yet, it was not clear that KG's strategy could be easily transferred to other markets. KG needed to decide on its desired growth rate and how it could manage growth without losing the uniqueness and decentralized culture that its senior management held in high regard.

According to PKF, the San Francisco-based hotel and real estate research firm, the projected profitability of the industry could, by the year 2000, reach the highest in at least a half-century. Gross margins could exceed 30 percent, fattening returns on investment and permitting aggressive expansion by KG into untapped markets.

Still, KG has insisted that the organization does not do deals just to do deals. By 1999, the group was managing almost 4,000 rooms in increasingly far-flung locations. Although privately held, KG executives revealed that revenues had grown by an estimated 10 to 20 percent per year in the past six years. The organization had been generating a consistent 15 to 20 percent return for its investment partners, all high-net-worth individuals including movie stars Paul Newman and Harrison Ford, as well as members of the Getty family. The level of return also exceeds the 13 percent return on investment target set by the Crow family.

In order to continue to differentiate itself from the competition, in 1999 KG added new amenities in its guest rooms such as telephones that easily accommodated laptop computers, easy chairs, desks with large work surfaces, and improved lighting. Technological trends that may affect the competitive landscape of the hotel industry included the emerging use of "smart cards" to replace cash and capture unique preferences of the hotel guest. Technology similarly made hotel-specific Web sites and bargain-hunting at sites like www.priceline.com almost ubiquitous within the industry.

According to Jeff Senior, KG was experiencing difficulty entering the Internet age:

> Fear of technology and systems is serious around here. The infrastructure does not exist. We have only one management information system person in this entire organization. We're not using e-mail. Our high technology is voice mail.

Also in 1999, KG began to emphasize on-site revenue management systems. This information would help general managers decide what each part of their operation contributed to profitability, which, in turn, would help senior executives at the group level to understand the potential for increasing internal efficiencies. Additionally, information access improvements were expected to give each property general manager a sense of decentralized decision making in spite of living under a corporate umbrella.

Strategic Meeting at KG: Afterthoughts

Before the 3:00 PM meeting with David Martin and Jeff Senior ended, Marx had an opportunity to explore with them the range of strategic choices that he thought were critical to the continued success of KG. Looking back after that meeting, Marx noted:

There are people in integral positions in this organization who remain "small thinkers" and who are afraid to step up to the plate. Our greatest fault is that we're sometimes not ready to put our money where our mouth is. That's a real danger. From the top, you've got to send a signal that it's okay to take risks, that it's (sort of) okay to fail. Mind you, we have made very few mistakes. Still, we have to be more careful about seducing ourselves that every market is the right place for our hotels. The problem is the fragility of the tourism economies in other cities, making it difficult to expand into new markets.

We're sort of disorganized; I know we like to kid ourselves about how "seat-of-the-pants" we are, and we say we're strategic but we're really very tactical. This is typical of the hotel industry. We are trying to be strategic in what really is a tactical industry. We need to decide where we're going in the future. You can't have two sides of an organization in conflict. We have tension that is unnecessary, sort of a push-pull between those managers that advocate returning to what we used to be and those that advocate changing into what we're going to become. Even Bill [Kimpton, the founder and chairman of the Kimpton Group] is torn.

We need to preserve our philosophy to enable a general manager to imprint their personality on an individual hotel. We need to continue to go to great lengths to attract and nurture people who believe that their success is also the success of the company. Always stay in touch with line employees. I actually want to hear bad news. Be unreasonable. Set unreasonable expectations. And always be really hands-on with our owners. These are hallmarks of what we do.

After the afternoon meeting with Martin and Senior, Marx wondered to what extent his successors could cope with the changing dynamics in the hotel industry and at the same time continue the open management philosophy and participatory decision-making style that had served KG so well during his tenure. The strategic choices to be made now fell—at least, temporarily—on Martin and Senior's watch. He wondered in what direction they would take KG and which issues they would make their priorities.

bibliography

Allen, J. L. "San Franciscan Making More Room at Inns." *Chicago Tribune,* March 18, 1998.

Anderson, R. *Atlas of the American Economy.* Washington, D. C.: Congressional Quarterly, 1994.

Armstrong, D. "Keeping Hotels Hot." *San Francisco Examiner,* July 18, 1999, p. B1.

"Front Desk." *Lodging,* July 1998, p. 16.

Garfinkel, P. "Bed & Breakfast? No, Bed and Dinner." *New York Times,* January 16, 1994.

Higley, J. "Kimpton Group Broadens Its Horizon." *Hotel & Motel Management* 213, no. 13 (July 20, 1998).

"Motels and Hotels." *Moody's Industry Review,* January 22, 1999.

"Ratings of Hotels & Motels." *Consumer Reports,* July 1998, p. 17.

Scatchard, B. "Occupancy Was Down Last Year." *Hoteliers' Infosource* 7, no. 1 (January 1999).

Smith, R. A. "Lodging Outlook Survey for the Year Ending December, 1998." Smith Travel Associates Research, www.hotel-online.com, May 16, 1999.

Tardiff, J. C. *U.S. Industry Profiles.* New York: Gale Research, 1998.

Templin, N. "Eccentric Sells: S. F. Firm Finds a Profitable Niche with Boutique Hotels." *Contra Costa Times,* April 17, 1999, pp. C1–C2.

U. S. Department of Commerce. *Census of Service Industries.* 1998.