



# Peru Orient Express Hotels (Peru OEH)

## A Case Study of the Development Impact of Tourism Hotels in Peru

### Context

Many countries are implementing tourism strategies under the mantra of “high-yield and low- volume” and trying to move away from mass tourism that can bring unsustainable social and environmental consequences. The high-yield-low-volume formula means that countries need to focus on higher value infrastructure, with quality accommodation a key component of this approach. There is increased recognition that higher yields per tourist (i.e. higher expenditure) delivers increased development benefits because it generates higher revenue and, due to higher standards of service required, supports higher employment ratios, better infrastructure, and staff skill development. Increased spending also yields higher levels of foreign exchange and tax revenues per visitor. In addition, the lower volume of tourists in turn reduces the environmental and social footprint of these tourists and helps foster more sustainable community relations.

In recognition of the significant economic impact of tourism, the Peruvian government has taken a number of policy measures to attract investment in the sector, including the privatization of hotels and the airline, as well as the creation of a strong set of investment incentives for the sector. With the combination of natural beauty and archeological sites, Peru has a strong base of attractions to support its tourism industry. At least 80% of the tourists visiting Peru go to Cusco and Machu Picchu and are seen as a driving force of the Peruvian tourism industry.



Monasterio Hotel, Cusco, Peru

marked OEH’s first investment into Peru. IFC’s investment helped provide long term funding for the hotel projects, when none was available at that time. In addition, IFC worked with POEH to establish a linkages project aimed at enhancing the benefits of the investment for the local communities.

Peru Orient Express Hotels (“POEH”) is a 50/50 joint venture between a local sponsor, Peru Hotels S.A., and Orient Express Hotels Ltd (“OEH”) and was established to develop and operate three concessions in Peru. OEH is an international operator of boutique hotels as well as luxury trains around the world. As part of long-term concession agreements signed with the Government of Peru, POEH manages and operates two hotel concessions (Machu Picchu Sanctuary Lodge and Monasterio Hotel) as well as the famed Cusco-Machu Picchu rail line (PeruRail) in the Cusco/ Sacred Valley Region.

IFC’s support for POEH was in line with the governments’ tourism strategy of higher value added tourism and also with the World Bank Group strategy of implementing projects that incorporate historic property preservation and restoration and other cultural heritage efforts. In addition to being one of the first international luxury operators in the hospitality segment, the project also

### IFC’s Long Term Support

IFC and POEH have had a long-standing client relationship that began with IFC’s first investment in 2000 to support the refurbishment of the Monasterio Hotel in Cusco and the Machu Picchu Sanctuary Lodge in Machu Picchu. The success of this first investment encouraged POEH to expand its offerings in Peru’s tourism sector. In 2007, IFC made its second investment to support POEH to undertake this expansion beginning with two other properties in Peru, the Nazarenas Convent in Cusco and the El Parador del Colca in the Colca Canyon. IFC has also supported OEH through the global facility, providing funding for the refurbishment of Miraflores Hotel in Lima, an 81-room high-end hotel property which OEH acquired in 2003. In addition, IFC supported POEH’s sister company, PeruRail, which has helped facilitate domestic travel by upgrading some of the railway stock between key destinations, particularly from Cusco to Machu Picchu.

### Key Development Outcomes

The following key development outcomes corresponds to first IFC's investment in POEH: US\$10 million towards supporting POEH's US\$23 million investment program to refurbish its 123-room Monasterio Hotel in Cusco and convert an adjacent building to the Monasterio Hotel (las Nazarenas Convent) to a 58-suite as part of Monasterio Hotel as well as refurbish the 32-room Machu Picchu Sanctuary Lodge (MPSL) in Machu Picchu (together referred to as "Project"). However, the las Nazarenas Convent conversion, which accounted for 50% of the total investment cost, was postponed due to delays in securing the necessary permits.

At the time of appraisal, IFC expected the Project to contribute to Peru's tourism infrastructure by:

- Providing high quality services at international standard levels, hence broadening the range of tourists in the area;
- Supporting the generation of foreign exchange earnings to the country and tax revenues to government;
- Direct and indirect employment opportunities, with the latter through increased economic opportunities for local businesses and farmers and other related services; such as restaurants, tour operators, souvenirs, etc; and
- Improving POEH's environmental, social and life safety standards in both hotels as well as ensuring the proper management of the cultural heritage sites-critical for its economic success and long-term sustainability.



Machu Picchu Ruins

### Financial Performance

Since IFC's investment in 2001, both Monasterio Hotel and MPSL have performed well. Gross revenues have increased by nearly 120%, while the average daily rates and occupancy rates have also more than doubled in the last 8 years, well exceeding IFC's projections at approval. While this strong performance can be attributed to a number of factors, including the improved tourism environment in Peru, much credit is given to OEH for designing and managing an effective upgrade, and improving the overall management, service and yield management of the property. It also attests to OEH's marketing strength, capacity to tap into their loyal clientele and ability to demand high rates through tour operators and their own reservation system.

### Economic Performance

Over the last several years, Peru has succeeded in repositioning its tourism image in the international market to appeal more to higher-spend travelers. POEH has successfully contributed to the positioning of the country as a high-yield destination, which has further allowed POEH to raise its rates while adding to the foreign exchange earnings of the country. The economic rate of return on the Project is estimated at 26%, higher than initially projected at 17%.

The Project allowed OEH to introduce its professional training, customer service standards, hotel management, and marketing techniques to Peru and thus change the profile of the tourists traveling to Peru by attracting travelers with higher spending patterns and longer stays. This, together with the amount spent by high-end clients outside the hotel (on average around US\$323 per day based on a survey on hotel clients), in the form of souvenirs, transportation, tours, meals, etc has had an important positive impact on the local economy.

Since the Project, POEH has increased its work force by 60% and it currently employs 325 staff of which 20% are female (202 in Monasterio Hotel and 113 in MPSL). The total annual benefits to the staff for 2008 amounted to US\$4.9 million, of which US\$2.6 million represents salary and the remaining US\$2.3 million accounts for other benefits, such as service charge and social security contributions. In addition, the local employees receive excellent training and have opportunities for internal growth and to work in other regional properties of OEH, which has resulted in its staff being the most sought after employees in the hospitality segment in the country. Given tourism is the main engine of the towns' economy with few alternative employment opportunities, practically all-private sector employment is directly related to tourism. The local students also receive internship opportunities at the hotels.

The Project has generated considerable economic activity during both the refurbishment and operational phases. The refurbishment lasted over three years and the total cost was nearly US\$7 million. The construction was undertaken by a local architectural firm and most of the furniture, fixtures and equipment were locally purchased. During the operational phase of the hotel, benefits accrue to a range of suppliers both within and outside the country. Total local purchases of goods and services for the operation of the hotel during 2008 amounted to US\$1.5 million.



Machu Picchu Sanctuary Lodge, Machu Picchu, Peru

### Environment and Social Performance

As both Cusco and Machu Picchu are World Heritage Sites, UNESCO was initially concerned with associated tourism operations, particularly with regards the Machu Picchu Historical Sanctuary. However, UNESCO has taken comfort from IFC involvement, and in particular, IFC's requirement in terms of environmental, social and heritage guidelines. The Project has resulted in MPSL having changed its exterior, in line with that of a World Heritage Site. As a result of IFC's involvement, both hotels were also subject to thorough fire safety audits. In both cases, significant upgrades were made. In the case of the Monasterio, these upgrades were particularly sensitive to the cultural heritage of the building, e.g., by providing glass fire doors.

At the time of appraisal, OEH agreed to build a wastewater treatment plant to replace the existing septic tanks at MPSL. However, it was only in 2008 that permission was granted for MPSL to begin with this process. As a result POEH has opened the tendering process for the construction of the plant.

Both Monasterio Hotel and MPSL have significant impact on the towns' economic and social activity. Local trash is transported from the town of Aguascalientes by PeruRail to Cusco where it can be processed and disposed of properly. POEH is also actively involved in the local community, working with a local orphanage to produce locally made cups to be sold in the Hotels, with all the proceeds to benefit the orphanage in addition to its direct contribution of about US\$9000 annually to the orphanage. Furthermore, it supports another local orphanage and elderly home with the total annual donation of US\$24,000.

### Private Sector Development

Tourism projects have a strong role in stimulating private sector development mainly through their linkages with the local businesses as well as through induced demand for other tourism related activities such as tour guides, restaurants, etc. POEH purchases most of its supplies and services locally, ensuring firms strive to meet the required standards. Encouraged by POEH's success, several high-end operators have established a presence in Peru (such as Marriot hotels) and the existing hotel operators have improved the quality of their assets and services to meet the changing profile of tourists in the region. This is an example of how IFC investment would have a strong demonstration effect in the development of the tourism sector.

Enhancing the Local Supply Linkage



Trout Farm, Urubamba, Peru

To enhance local community relations, IFC’s investment and technical assistance departments approached OEH in 2004 with a proposal to support local communities through economic-based activities. IFC and OEH agreed to collaborate on a six month pilot program focused on linking local producers and service providers from the region to commercial opportunities with POEH. The goal of the program was to successfully demonstrate the ability of local producers and service provider to meet OEH standards and thereby encourage OEH to expand on the pilot activities to further enhance the benefit the local communities. IFC also supported POEH on development of a community outreach and communications strategy, providing a structure for POEH to continue working with local communities and scaling up its existing activities.

The program has succeeded in improving the quality of local farmers’ produces with resultant sales to POEH at higher prices. It has also helped to identify, form, and train a traditional dance group, in coordination with a local indigenous association, to provide entertainment to tourists at a rail stop of the train service operated by PeruRail.

Given the success of the pilot program in these areas, POEH has continued this work with local producers. Since 2006, Monasterio Hotel has been working with the Community of Huama, in the District of Lamay, Province of Calca, Cusco, with 40 families producing native potatoes delivered weekly to the Hotel. At present, following a rapid growth in demand for such products, this has grown into an association of producers of native potatoes that includes 5 communities, and benefits about 250 families. They are now expanding their market by supplying to all other tourist restaurants and hotels in Cusco. Starting April 2008, the Hotel began its involvement with with the Regional Association of Farm Producers of the Cusco (ARPAC), which involves about 10,000 local farmers of different products including fruits and vegetables. ARPAC’s main objective is to organize the farmers and sell their products directly to consumers. The Hotel now purchases most of its fruits and vegetables directly from ARPAC.



Dance Group at Poroy Rail Station, Poroy, Peru

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