Asset Management – Why Bother?

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In the course of each year my colleagues and I see a huge number of hotel P&Ls and, within them, there are often wide variances in performance, even in like-for-like situations – whether it is better or worse revenue generation, cost control or effectiveness. Some hotel management companies don't produce an adequate return on their owners' investment by doing as much as they possibly can to increase revenues, reduce operating costs and improve bottom-line profits and cash flow. Only when given a 'kick' from the owner or from a third-party asset manager acting on behalf of the owner does the optimisation of a hotel's performance – and therefore its value – often become a reality.

So why is it that so many owners feel the need to employ asset managers, whether in-house or via a third-party specialist, to help them ensure the manager is doing a good job (and preferably a great one)? Why don't many operators do this on their own?

After 45 years of looking at hotel operating performance, here are my top 10 tips for getting the most out of your hotel business.

1. **Really incentivise your manager.** Most management companies charge fees based on a percentage of top-line revenues and a percentage of ensuing profits – typically adjusted GOP (gross operating profit – revenues less all operating costs and base fees). But management companies won't usually agree to the profit percentage being based on real net profits, after all deductions. That's what most owners would like. They would also like zero % base fees, with operators' fees being solely based on a percentage of cash profit generated (albeit a higher percentage than currently, with perhaps a 'stepped' arrangement, with the percentage rising as the amount of cash increases). That would certainly start to make management contracts more owner-friendly and make for some interesting contract negotiations.

2. **ALL of the hotel needs to make money (i).** It's disappointing to see the number of hotels which produce a great contribution to overheads from the Rooms department but which fail to make more than a token profit – and sometimes not even that – from its F&B operations. Most hotels have a huge investment in restaurants, bars, lounges, meeting and banqueting rooms, to say nothing of multiple kitchens and back-of-the-house areas, that it dismays me not to see a decent return on this investment. Some meals, such as breakfast, afternoon tea and often banqueting, can be quite profitable but we seem to lose the plot overall. Unless F&B is making at least a 15% contribution to overheads, it cannot be described as profitable. The 15% allows for a notional rent and is the bare minimum an operator should expect to achieve. Anything less than this and you're not really making money.

3. **ALL of the hotel needs to make money (ii).** As well as making a decent return from F&B operations, the same attitude needs to be applied to other departments, such as spas and health clubs. They too need to more than cover their costs. Maybe revenues can be improved, such as by check-in staff selling treatments – once they have finished 'upselling' the guests to a better room or taken a dinner reservation for them. Many hotel operators recognise that the staffing of their leisure facilities has to be at a certain minimum level, but that shouldn't stop everyone from making a more concerted effort to improve the revenue, from hotel guests and non-residents alike.

4. **ALL of the hotel needs to make money (iii).** To help operators manage the buildings they manage comes the need to speak the language of real estate investors, who typically measure performance as an amount per square foot or per square metre. Hotel operators seem reluctant to do this, probably because the results are

Summary

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not impressive and somewhat embarrassing. I suggest it is probably laziness. Every hotel operator should be able to report revenues and profits per square foot/metre for the whole hotel as well as each operating outlet; those which operate multiple hotels then have some useful benchmark data to compare individual hotel and outlet performances. Investors can then compare hotel performance with other real estate asset classes such as offices, residential, retail and so forth. This is an essential step towards identifying dead space and areas of the building with true potential for value creation.

5. **Don't assume a good RevPAR produces a good GOPPAR.** Nearly 20 years ago I started writing about the importance of tracking GOPPAR (gross operating profit per available room). Having decided that hotel operators were starting to understand what RevPAR meant – rooms revenue per available room – I thought they could cope with the rigours of GOPPAR. Wrong! You only have to look at how hotel operators have embraced the online travel agents (OTAs) to realise that they are seduced by the uplift to room occupancy and rooms revenue which they bring, whilst forgetting this comes at a significant cost – a commission usually of at least 18% and sometimes 25% quickly eats into the increase in RevPAR and often produces a decline in GOPPAR. And we shouldn't forget that the hotel management company is heavily incentivised to produce an increase in revenues, adding say 2%-3% to their coffers without the owner receiving a penny increase in their profit share. This is equally important across F&B outlets, meeting space and other revenue-generating areas – the hotel's revenue management strategy must incorporate a strategy to focus on contribution to overheads per available cover, meeting slot, treatment hour and so forth.

6. **Half of all marketing budgets are wasted.** The trouble is, no one knows which half. Each marketing initiative within a hotel's marketing budget needs to be scrutinised – just because you have attended a particular event for years doesn't mean it is still relevant. Each initiative should be SMART – specific, measurable, action-oriented, realistic (achievable), and time-bound (within a specific timescale). Most initiatives are not directly measurable – if any of yours are not, what can be done to devise a system that measures the effect (for example, rooms sold, restaurant covers sold, and so forth) and attaches a financial benefit as well. Measuring the cost vs. the benefit enables a hotel operator to determine whether particular activities should be continued or cancelled.

7. **Budgets are important; forecasts even more so.** So, you spend weeks carefully producing a budget for each department which builds to the whole hotel. Usually this needs to be completed by the end of November, but many hotel management companies will have started the process in August as they cannot possibly share this with the owner until every layer of corporate management has had their say and signed off on it. Some owners are lucky enough to get to 'approve' the budget; many hotel companies do not even offer this courtesy. With a bit of luck, the Q1 budget might reflect something close to what the actual might produce, but most hotels start to find material differences start to develop as the year progresses. Even more important, therefore, is to present an up-to-date forecast of the forthcoming three months along with each month's historical results, how this varies from the previously defined budget, and the expected impact for the remainder of the year, particularly the effect on the bottom line, because that's really what the owner is interested in after all.

8. **Who is earning what in the relationship?** For good measure, you should show what the expected earnings of the management company are compared with those of the owner at all levels – budgets, forecasts and actuals. There's nothing worse than seeing a hotel operator earning more when the owner is earning less. And it isn't just in terms of base and incentive fees, but all the other charges which the management contract inconveniently mentions in different places – sometimes in different contracts – such as marketing fees, licence fees, group service fees and so forth. It's worth looking out for instances where hotel operators gain a commission from certain bookings even when it has had no direct action in the activity, such as when bookings are routed through its booking channels, thereby subjecting the hotel to a double dose of commission. Many owners resent paying a branded hotel operator to run their hotel when they then encourage large numbers of bookings to be made by online travel agents, from which the management company earns fees. Owners feel that such bookings should be kept at a minimum, with as much as possible being generated directly by the operator or through brand.com. But what is an 'acceptably low' level?

9. **You cannot take a percentage to the bank.** Hotel people seem to be obsessed by percentages – food cost percentages, labour cost percentages, occupancy went up by this percentage, average rate by that percentage,

we made 'x' per cent profit, and so forth. We should have been given a clue when it became clear that occupancy percentages alone were insufficient to measure a hotel's performance – average rate was then added into the mix and, hey presto, RevPAR emerged with GOPPAR following on, although there are many hoteliers yet to discover the advantages of knowing this, despite it being around for the last 20 years. Many hotel management teams continue to push percentage performance measures as being the be all and end all of hotel operating results. Whilst (some of) these might be helpful, it's money that really talks when it comes to a hotel's performance and operators would do well to remember this.

10. **A good general manager will have a great management team.** I am always asked whether a certain person is a good GM, so here are my criteria. A good GM ensures that her/his hotel makes enough money to produce an acceptable return on the owner's investment – and who strives to accomplish this at all times. The really good ones are supported by a team of managers or department heads that operate in a collegiate fashion, where information and opinions are shared, where people listen to and respect each other, where there are common goals and objectives – in short, where everyone 'sings from the same hymn sheet'. It never surprises me when a great management team makes more money for an owner (and often themselves), more so than an average team can accomplish.

It is conceivable that your hotel's operations could benefit from an initial operational review – a short exercise intended to flush out areas of strength and weakness, identifying potentially opportunities to improve revenues and reduce operating costs, thereby strengthening the bottom line and improving both return on investment and value. Such a review ought also to reveal instances where continuing oversight might be required to help monitor and encourage the improvement in your management's performance over a more extended period of time.

So, on balance, does your hotel's management produce the sort of returns you consider to be acceptable? Are they doing enough to manage your asset on their own, or could the intervention of a third party enable their performance to be improved and enable what might already be a good management team to become a great one in your eyes?

About Russell Kett

Russell Kett is Chairman of the London office of HVS and also serves on the worldwide Board of HVS. He has 40 years' specialist hotel consultancy, investment and real estate experience, focused on providing valuation, feasibility, shared ownership, property, brokerage, investment, asset management, strategy and related consultancy services, advising hotel companies, banks, developers and investors on all aspects of their hospitality industry related interests, throughout the EMEA region. Russell is a frequent writer, moderator and speaker on the international hotel industry, especially topics relating to hotel valuation, investment, marketing and finance. He is a frequent visitor to Israel and maintains a home there. For more information, contact: