Operate

5 ways to optimize hotel profitability via a third-party operating model

by Derek Olsen, CHMWarnick | May 23, 2018 12:58pm

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Hotel asset managers bring a unique perspective and understanding of how to optimize performance and achieve investment objectives—one that's based on observation and close collaboration with a full spectrum of brand and third-party operators across a multitude of scenarios (brand, market, property type, economic cycle). While we have learned many lessons and adopted a wide range of best practices over the past two decades with over 400 hotels matriculating through our asset management portfolio, we have identified five key considerations for hotel owners looking to optimize profitability, specifically though a third-party operating model.

1. Choose Wisely

The ability to optimize hotel profits through third-party operators starts with selecting the right firm. While seemingly obvious, this may be easier said than done, with upwards of 200 firms marketing hotel-management services today. While many groups may appear to check the box in terms of capabilities and track record, our experience has demonstrated that on a good day, less than 30 percent of these groups are even worthy of consideration and, even after culling the list down to those truly qualified groups, it's not "one-size-fits-all."

The specific needs of an investment must drive the decision about what qualifications, capabilities and skills will be most important to the selection process. For instance, we've seen a fantastic operator with hotels consistently performing above fair share, completely tank during the pre-opening sales effort for new development—not a good fit. We've watched exceptionally skilled labor managers struggle to operate a luxury lifestyle hotel. And, we've witnessed an operator with more than 200 hotels fail miserably because they lacked specific-market experience, rendering local sales completely ineffective.

Simply put, even a reputable operator, may not be the right operator. Understanding the DNA of each group is key to ensuring dominant genes support those priorities that are most critical to the success of your specific investment's needs. Some of these factors may include: project phase (under construction, open, stabilized), local market knowledge, tier/positioning, asset type, mix of business, brand affiliation, and unique location (convention, resort, airport), among others.

(For the points that follow, the assumption is that step one has resulted in the successful selection of a highly-qualified, best-in-class operator that is suited to the specific investment at hand. Absent that, the ability to achieve meaningful profit optimization will be severely limited.)

About the Author

Derek Olsen, CHMWarnick

2. Achieve Alignment

I'd like to take a moment to discuss those factors that elevate "operators" to "partners," and not in the financial sense, but rather superior alignment that can be achieved at the onset of the relationship during contract negotiation, as well as throughout the course of the relationship. Third-party operators are inherently more flexible, offering less restrictive and often shorter contract terms, typically more open to incentive-based fee structures and extending termination rights upon sale. The ability to sell a hotel unencumbered by management (improving cap rate and valuation on sale) alone can optimize value from day one. Like all negotiations, it's a give and take. Focus on those opportunities that will be of greatest value and influence for your specific investment—whether a lower base fee and higher incentive to shorter-terms and/or termination upon sale. These are areas that will prove far more valuable to the investment over the long-term.

Another area for creating alignment comes from establishing performance expectations. In our experience, the corporate team developing performance projections are much closer to the operation, with fewer levels between "management contract sales" and the operations team. In many cases, we've found those folks responsible for developing the pro forma to be the same regional ops personnel ultimately responsible for overseeing performance.

In short, this generally improves reliability of projections and accountability for performance. In all instances, don't be blinded by assumptions that look "to good to be true" and make sure performance expectations are not simply aligned, but also reasonably achievable. Another critical area toward achieving alignment with direct influence on profitability is through the property executive team. A common challenge for many third-party operators is insufficient availability of management talent during rapid company growth. As a result, we tend to see slightly higher turnover and longer periods of vacancies for key positions. Having approval rights over key executive positions and making sure you have the right leader—the GM—from day one is crucial to paving the path toward profitability.

Regarding key money, don't lose sight of the mission at hand—selecting the right operator for your hotel! Having proverbial "skin in the game" does not always serve to align interests as investors might think, but rather can serve to bind owners, eliminating one of the most compelling reasons to hire a third-party operator in the first place—flexibility. If you need money, your operator should be the option of last resort.

3. Start "Flexing"

One of the aspects we have come to appreciate most with the third-party operators we partner with in our asset-management practice is their entrepreneurial spirit and flexibility. Greater flexibility can translate into both revenue and costs-savings opportunities. Examples may include trying new revenue strategies (independent of cluster pricing), being able to pick and choose (as a franchise) which brand programs to participate in or opt out of based on cost/value, pushing back on nonsensical brand standards, pursuing initiatives that are more directly tied to a specific market and overall greater efficiency through labor and forecasting.

Today's most successful third-party operators manage properties across multiple brands and understand the need to be nimble, reacting quickly to changing market conditions, thinking outside the box, identifying opportunities and taking calculated risks.

Generally speaking, third-party operators are less restricted when it comes to acting on behalf of ownership, unencumbered by short-term quarterly result pressure impacting longer-term strategic decisions, layers of management, approvals and brand-guidance hanging over their heads. In many instances, management companies are also owners, so having this shared perspective and bottom line focus can be invaluable.

4. Collaborate

Collaboration is the key to success, breaking down the walls and fostering mutual trust to identify where additional resources may be needed. Executive talent, labor management, guest service, physical stewardship of the asset, precision forecasting—this is where your management company lives and should excel. That being said, there are other areas that may not come quite as naturally, or be as fully supported based on lack of resources or other limitations. This is not unique to third-party operators—having a "weak spot" is prevalent throughout many operating structures. For some, this will be revenue management, others group sales and distribution, and still others adopting new, more efficient technology. Even the best operators can use additional resources, and the better the relationship, the more open the conversation and greater opportunity to improve. It is also important to recognize when you need to call in corporate support and additional bench strength, which may be more readily attained within a third-party-operated environment.

5. Challenge & Empower

Traits shared by the most revered third-party operators include an entrepreneurial spirit and general mobility to make quick decisions and adapt to market changes and willingness to test new strategies. While operators may do this on their own, we've found the highest rate of success comes when owners (or in many cases, their asset managers) are continually challenging the status quo and ensuring alignment of interests on a continual basis. In most cases, healthy debate and respectful challenge is welcome, but needs to be channeled in the areas where there is most to gain, and needs to come from a place of mutual respect and expertise. Likewise, empower and reward the team to think like an owner, identify opportunities, present ideas and take calculated risks. That's a win-win situation for everyone involved.

Derek Olsen is an SVP at CHMWarnick, a provider of hotel asset management and owner advisory services globally. The company asset manages over 70 hotels comprising approximately 29,000 rooms valued at roughly $15 billion, and is advising on hotel development projects valued at over $2 billion. CHMWarnick's owner advisory services include asset management, hotel planning and development, acquisition due diligence, owner-entity accounting, management/operator selection and negotiation, capital planning and disposition strategy. It has eight offices nationwide.

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