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Introduction

The increasingly popularity of third-party managers indicates how investors in the hotel industry are beginning to demand clarity in the black box labelled “operations”. Previous approaches of putting the management of hotels into the same category as the brand offering are no longer being accepted. A clearer definition of the value created in running hotels is needed.

This report is not focused on how to be a better chef or the best way to clean a room: rather the report explores how value is created by managing chefs and housekeepers more effectively. It highlights how focused management across all aspects of the hotel will deliver the best results and hones in on just what the management looks like.

This report begins by looking at the rise of third-party management companies. The report aims to answer questions such as what has brought the growing interest in third party management companies? Who are the major players in third party management? How is the industry evolving on a regional level? And what are the major trends and issues impacting this particular sector of the hospitality industry?

Next it moves on to look at outsourcing, a trend which presents both strong advantages and disadvantages to today’s hotel operator. Examples of outsourcing in the industry are presented.

Property technology is of course an important component of hotel management. Subjects such as the Internet of Things, in-room offerings, point of sale and property management are reviewed.

The future shape of contracts in both franchise and management of hotels are an essential element of hotel operation and these will be discussed.

Keeping costs under control is a major challenge for any hotel operation and the report discusses the latest thinking in procurement.
Third party management companies

Introduction

There are five main business models within the hotel industry, with a number of permutations within each of these models, they are as follows:

- Property fully owned and operated by the hotel brand;
- Property leased by a hotel brand, which pays rent for the “walls”;
- Property owned by a third party and managed by a hotel chain;
- Property owned by a third party and managed by a “non-branded” specialist management company;
- Property owned by a third party, with a franchise agreement with a hotel chain.

Background

The European hotel industry has changed significantly in the last decade as a growing number of companies have sold off their assets to focus on managing and franchising their operations; or have sold them only to lease them back and use the capital to fund their expansion into other markets.

It’s a similar picture in the US, where hotel groups have sold their properties and invested money into their brands and management expertise, since franchising and managing hotels offer higher profit margins than running real estate.

The move from owned to asset-light began in the 1990s as ‘traditional’ hotel companies looked to dispose of their asset intensive portfolios for a lighter portfolio of managed/leased and franchised hotels. This trend has been driven by a number of factors:

- Recognition of hotels as an asset class for property investors.
- Increasingly high prices paid due to cheap debt and a large surplus of oversupply for more traditional commercial property investments.
- Shareholder demands for owner/operators (especially listed companies such as IHG, Hilton and Accor) to release capital from their balance sheets to return to shareholders and improve return on capital employed.

Thus hotel companies embarked on a series of sale and leaseback, and sale and manage-back deals. Sale and leasebacks have been used for a long time as a way of releasing value from a real estate investment and hotel companies have certainly not been the only sector where this was common. Sale and manage-backs became common as part of the disposal programmes of the big owner/operator chains that were moving towards becoming asset light hotel management companies rather than owners of real estate.1

Publicly quoted hotel operating companies began divesting of owned real estate and focussed on management as they were unrewarded for ownership stakes in hotels. Asset-light strategies enabled them to release capital, lighten their balance sheets and execute share buybacks, consequently increasing their share price. Practically speaking, hotel owners were focussing on building a base of long-term management contracts and stronger brand footprint in order to attract new capital sources and develop more predictable revenue streams.2 IHG has

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1 Journal of Retail and Leisure Property (2007) 6, Page, ‘Asset-light – managing or leasing’
2 Jones Lang LaSalle Hotels, The Hotel Ownership Pendulum in Motion, 2006
pursued this strategy, and now owns less than 1% of its hotel portfolio; management contracts account for about a quarter, and franchising the remaining three quarters.

Reasons for adopting an asset-light strategy include:

- Higher capital turnover as a result of lower capital invested means that the return of invested capital is greater.
- It helps to ease system growth and expansion of brands, and the brand awareness among customers, as it requires less capital.
- Financial risks for hotel operators are normally lower in hotels under management and franchise contracts without guarantees, compared with hotel ownership.
- Separation of hotel operations and property ownership implies less financial leverage and increased focus on hotel operations instead of property asset management.

This change in ownership structure has opened up opportunities for companies to provide hotel management expertise to the new hotel owners, many of which lack knowledge in the hospitality industry[^3].

**INDUSTRY INSIGHT:** Paul Slattery & Ian Gamse, Otus & Co. discuss the question – Asset-light hotel companies: where next?

If the global major hotel companies had not made the transition to asset-light, the valuation of their shares and thus their corporate valuations would have collapsed. However, the transition to asset-light has not delivered much of a re-rating of their shares in spite of reducing the risk profile of the companies, accelerating the growth of the companies, focusing more on the hotel business and generating more free cash. The companies are now faced with complex strategic issues about the performance of their portfolios and about how they will be able to achieve a medium- to long-term rate of growth that will sustain and enhance their valuation multiples. These are very adult issues that will require the main boards of the global majors to analyse, more creatively than they have done in the past, the economies in which they operate and aspire to operate. It will also require them to capture greater market share of hotel supply and demand in ways that does not impede hotel and chain performance. The most able managements will be those that deliver faster sustained growth than their global major competitors. Sadly, there is little sign that, thus far, they have had many good ideas.

Source: Hotel Analyst, Volume 8, issue 2

Global hotel companies are the most advanced with their asset disposal programmes, due in part to their early starts, Marriott in 1993 with its separation from Host Marriott and IHG in 2003 when it undertook a detailed review of its hotel stock. IHG and Marriott own less than 1% of their hotel assets, with Hilton owning/leasing 3% of its hotels. Of those properties Hilton actually owns itself, a number are its ‘brand builders’, which include the Waldorf Astoria, Hilton Hawaiian Village, and the New York Hilton, which are among its biggest profit earners. Choice International and Wyndham Worldwide operate a fee-based franchise model.

The leading US players have differing levels of hotel ownership, with Hyatt has some 12% of its hotel rooms owned/leased, followed by Carlson which owns c.10% and Starwood with just 3%.

[^3]: Global Hotel Perspectives 2014 published by Hotel Analyst
Changing ownership patterns: As hotel companies continue with their asset light approach to their portfolios, this has brought about changes to ownership of the actual hotels themselves. Many new investors in the hotel industry do not have an industry background and want to use third party management companies and asset managers to ensure that their investments yield the highest returns. These new investors are principally institutional investors, private equity, real estate investors and in some instances High Net Worth Individuals (HNWIs), particularly for trophy assets.

New supply: Increased levels of hotel development again lead to new entrants into the hotel industry. Some of which are new to hotels and therefore need the expertise of third party management companies.

Evolution of the concept

The US

Third party management companies are far more established in the US than in other parts of the world, due to the maturity of its hotel industry, where franchising is far more the norm, and the change in hotel ownership has led to owners looking for expertise in hotel management.

Table 1: Leading third party management companies in the US (2015)

<table>
<thead>
<tr>
<th>Rank</th>
<th>Company</th>
<th>Third-party managed rooms at end 2015</th>
<th>Third-party managed hotels at end 2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Interstate Hotels &amp; Resorts</td>
<td>76,361</td>
<td>427</td>
</tr>
<tr>
<td>2</td>
<td>Aimbridge Hospitality</td>
<td>63,919</td>
<td>449</td>
</tr>
<tr>
<td>3</td>
<td>Highgate</td>
<td>24,860</td>
<td>88</td>
</tr>
<tr>
<td>4</td>
<td>Crescent Hotels &amp; Resorts</td>
<td>23,258</td>
<td>97</td>
</tr>
<tr>
<td>5</td>
<td>White Lodging Services</td>
<td>21,540</td>
<td>144</td>
</tr>
<tr>
<td>6</td>
<td>Remington</td>
<td>18,112</td>
<td>94</td>
</tr>
<tr>
<td>7</td>
<td>TPG Hotels &amp; Resorts</td>
<td>17,652</td>
<td>63</td>
</tr>
<tr>
<td>8</td>
<td>Pillar Hotels &amp; Resorts</td>
<td>16,829</td>
<td>178</td>
</tr>
<tr>
<td>9</td>
<td>HHM</td>
<td>16,500</td>
<td>120</td>
</tr>
<tr>
<td>10</td>
<td>Pyramid Hotel Group</td>
<td>16,214</td>
<td>62</td>
</tr>
</tbody>
</table>

Source: 2016 Hotel Management Survey
Key players

### Interstate Hotels & Resorts

- **Ownership**: Thayer Lodging and Jin Jiang Hotels
- **Hotel & rooms**: 447 hotels (81,205 rooms); 33 hotels (4,860 rooms) in the signed pipeline
- **Geography**: US, Belarus, Belgium, Bosnia & Herzegovina, Canada, China, Ireland, Kazakhstan, Russia, UK
- **Brands**: Hilton, IHG, Wyndham, Accor, Marriott, Starwood, Best Western and independent hotels

**Background**

- **1960**: Established by Milton Fine and Edward Perlow.
- **1970s**: Began its partnership with Marriott International; Formed Crossroads Hospitality (1992); Company entered Russia (1995); IPO of Interstate Hotels Corp (IHC) (1996); IHC is acquired by Patriot American (1998)
- **2000s**: Company is spun off as an independent management company (2000); IHC and Meristar Hotels & Resorts merge to form Interstate Hotels & Resorts (2002); Acquired Sunstone Hotel properties (2004);Entered Belgium and Ireland (2006); Formed a joint venture with Ireland's Harte Holdings to buy four hotels from Blackstone for USD207.8mn (2007); Formed a joint venture with JHM Hotels and formed JHM Inter Hotels India (2008)
- **2010s**: Interstate was acquired by a 50:50 joint venture between Thayer Lodging and Jin Jiang Hotels. The deal was worth just over USD300mn and launched what was described as the first independent hotel management company in China, Interstate China Hotels & Resorts, when it formed a partnership with Jin Jiang Hotels (2010); Assumed management of Summit Hotel Properties (2011); Thayer Lodging was acquired by Brookfield Asset Management (2014); Acquired the management agreements of Rim Hospitality for an undisclosed fee (2014)

**Operating model**

- Not wholly a management company, but also has ownership interests in 25% of its hotels
- Also operates under Interstate China and JHM Interstate India

**Strategy**

- Moving into Europe – see under Interstate Europe
- Aiming to manage 800 hotels at some point in the not-too-distant future
- Regardless of the region, Interstate prefers to do business where there is density of hotels and where franchising is the preferred model
- Strategy is to grow through acquisitions and consolidation. The company has more than doubled its size in the last three years under CEO Jim Abrahamson
- There is also the opportunity presented by the recent relaxation of the overseas investment laws in China. With more potential owners seeking hotels, it will be well-placed to use its advantage through Jin Jiang Hotels to present itself as the management team of choice and continue its global growth

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### Aimbridge Hospitality

- **Ownership**: Lee Equity Partners is leading shareholder
- **Hotel & rooms**: 449 hotels (63,000 rooms)
- **Geography**: US and the Caribbean
- **Brands**: All brands within Marriott, Hilton, Hyatt, Starwood, Wyndham and IHG

**Background**

- Founded by Les Bentley and Dave Johnson (2003); Launched Interim and Receivership platform (2009); Launched Luxury & Resort Division (2010); Launched Channel Point Hospitality Division (2012). Acquired Evolution Hospitality (2015)

**Operating model**

- Independent management company

**Strategy**

-
Redefine BDL

Ownership  Redefine International
Hotel & rooms  64 hotels
Geography  UK, South Africa
Brands  Seven brands and independent hotels; Works with global brands such as IHG, Wyndham, Starwood, Hilton, Accor, Marriott and Best Western in the UK

Background  
1997  BDL was launched by Louis Woodcock and Stuart McCaffer
2006  BDL signed a seven year deal with Wyndham to develop the Ramada Encore brand in the UK, in association with property investor Capital & Provident
2011  BDL took over nine Ramada hotels previously managed by Jarvis
2013  The newly renamed Redefine BDL was formed, combining BDL Management and Redefine International. Since the merger, the company has signed four management deals. Redefine is part of Redefine International, whose parent Redefine Property Group is listed on the Johannesburg stock market, and owns a portfolio of hotels, including several IHG branded hotels in the UK
2014  Tsogo Sun, one of South Africa’s leading gaming, entertainment and hospitality groups, invested in 25% stake in the company

Operating model

Strategy
On discussing the merger, Helder Pereira, chairman of the new combined entity said “we see this as a strategic move which will enable us to be one step ahead of the trend for consolidation in Europe, mirroring what we are witnessing over in North America. We see significant opportunities to grow our business, both through acquiring new management contracts, and by partnering with owners and developers to deliver optimum performance from their assets, helping them to realise their full potential”

- The growth will also build on Redefine’s current hotels under management in Liberia and South Africa. The company is looking at opportunities in both the east and west of the continent.
- Has a publicly stated target to growing to 100 hotels by 2016
- 2016 will see the business further strengthen its UK portfolio and develop its strategy for a move into other countries in Europe

And the Middle East and Asia Pacific.....

Owners and operators in the Middle East disagree on whether the market is ready for third party operators to take over the running of hotels.

According to CEO of IFA Investments Joe Sita there had been talk about franchising licensing, however the model was not very prevalent in the Middle East.

However, Sita strongly advocated for third-party operators who are more focused on the bottom line, saying: “I think the US model actually works best where brands focus on the brand and the delivery of the business and the positioning of the brand, and delivering the customer. And then you use third party operators who are more specialised and focused on the bottom line to actually manage the business and they work across a range of brands and properties.”

“It’s worked with properties we have acquired in the US and I found there’s a much better alignment of interests when you do that. So to me that’s a model that needs to develop here. I think there is room for getting people to focus on what they’re good at,” he explained.

Hilton Worldwide president Middle East & Africa Rudi Jagersbacher, however, argued the Middle East was not ready for franchise and third-party agreements to be the norm.
“The franchise model I think would certainly work with the right product in the right location. I don’t think we are necessarily ready for that in the Middle East or Africa. I think it’s an emerging market, we want to be in control of the brand, we want to make sure that we are successful, we want to make sure our brand standards are fully implemented. And I think it’s really important to show our investors that before you go into a franchise agreement, you want to see what is happening with the local market, how are the brands operating within the local market,” he said15.

The profitability of a franchising model in the Middle East as well as maintaining the brand’s reputation are also key factors of concern for hoteliers.

“It is actually quite difficult to make money from the franchise model unless you can develop critical mass and that really does bring you to the big markets in the region, potentially the kingdoms of this world, and other markets where you can actually build and leverage some significant infrastructure for yourself as a franchisor and for your franchisee,” said Alex Kyriakidis, president and managing director Middle East and Africa, Marriott International, Inc.

Pascal Gauvin, CEO of IHG, India, Middle East and Africa, which has 22 franchise contracts in the Middle East believes it depends on the maturity of the region or market.

“We need a bit of sophisticated market, a mature market. It needs to be the right partner, making sure the infrastructure is right because what is important to us is our brand, and all brands have to perform so it could be through a managed contract or through a franchised contract,” said Pascal.

“I think it’s a matter of time,” agreed Kyriakidis. “I believe it’s a matter of the markets here developing operating expertise over time so that you then have qualified franchisees come forward and then we both as partners have comfort in working with each other, partnering with each other to go down the path of a franchise model.”16

In 2015, a third party management company, Aleph Hospitality was launched in Dubai. The company will specialise in the operation of internationally recognised hotel brands across the Middle East and Africa17.

Asia Pacific

The concept of third party management is still in its early stages in Asia Pacific, but it is a sector which will see growth over the next few years. Interstate has operations in both China and India, so the concept has been introduced into these two major markets.

One of the principle third party operators in China is Interstate Hotels & Resorts, who back in 2010 was taken over by a joint venture between Thayer Lodging and Jin Jiang Hotels, China’s leading hotel operator and developer. Shanghai-based Interstate China Hotels & Resorts is pioneering hotel management in the region. The partnership has developed the resources and infrastructure necessary for comprehensive hotel management.

Abrahamson CEO of Interstate, said he expects the third party management concept to catch on more—particularly with its partnership with Jin Jiang Hotels, a hotel owner in China.

Outsourcing

Background

Outsourcing is a practice used by different companies to reduce costs by transferring portions of work to outside suppliers rather than completing it internally.

Outsourcing is an effective cost-saving strategy when used properly. It is sometimes more affordable to purchase a good from companies with comparative advantages than it is to produce the good internally. An example of a manufacturing company outsourcing would be Dell buying some of its computer components from another manufacturer in order to save on production costs. Alternatively, businesses may decide to outsource bookkeeping duties to independent accounting firms, as it may be cheaper than retaining an in-house accountant.

The reason for outsourcing is in most cases driven by a desire to reduce costs while at the same time maintaining or even improving the quality of service. This is often the case where the function being outsourced is labour intensive.

Payroll is the largest cost centre for almost all functions within the hospitality industry, so any opportunity to outsource functions that can be performed off-property to lower salary areas is attractive.

Hotels are advised not outsource when a function involves direct guest contact at the property, such as concierge, housekeeping and front desk employees.

Table 5: Outsourcing functions

<table>
<thead>
<tr>
<th>Functions most likely to be outsourced</th>
<th>Functions least likely to be outsourced</th>
</tr>
</thead>
<tbody>
<tr>
<td>Laundry</td>
<td>Concierge</td>
</tr>
<tr>
<td>Pool maintenance</td>
<td>Housekeeping</td>
</tr>
<tr>
<td>Grounds keeping</td>
<td>Front Desk</td>
</tr>
<tr>
<td>Equipment maintenance</td>
<td>Switchboard operations</td>
</tr>
<tr>
<td>Restaurants/food service</td>
<td>Porters</td>
</tr>
<tr>
<td>Some maintenance contracts</td>
<td>Front office</td>
</tr>
<tr>
<td>PR and marketing</td>
<td></td>
</tr>
<tr>
<td>Revenue management</td>
<td></td>
</tr>
<tr>
<td>Information technology</td>
<td></td>
</tr>
<tr>
<td>Reservations</td>
<td></td>
</tr>
<tr>
<td>Project management</td>
<td></td>
</tr>
<tr>
<td>Purchasing of furniture, fixtures and fittings</td>
<td></td>
</tr>
<tr>
<td>Operating supplies purchasing</td>
<td></td>
</tr>
<tr>
<td>Help-desk support</td>
<td></td>
</tr>
<tr>
<td>Loyalty programme management</td>
<td></td>
</tr>
<tr>
<td>Distribution management</td>
<td></td>
</tr>
<tr>
<td>Accounts</td>
<td></td>
</tr>
<tr>
<td>Finance services</td>
<td></td>
</tr>
</tbody>
</table>

Source: www.hotelnwstopedia.com

31 http://www.investopedia.com/terms/o/outsourcing.asp
Advantages and Disadvantages in outsourcing

Advantages

- Outsource non-core activities and spend more time concentrating on the core business processes
- Offshoring gives the business access to professional, expert and high-quality services
- The organization can experience increased efficiency and productivity in non-core business processes
- The company can streamline its business operations
- Offshore outsourcing can help the business save on time, effort, manpower, operating costs and training costs, giving it overall cost advantage
- Outsourcing can make the organization more flexible to change
- Experience increased control of the business
- Save on investing in the latest technology, software and infrastructure and let the outsourcing partner handle the entire infrastructure
- Get the assurance that the business processes are being carried out efficiently, proficiently and within a fast turnaround time
- Offshoring can help the organization save on capital expenditures
- By outsourcing, the company can save on team management problems as its offshore partner will be managing the team who does the work
- Cater to the new and challenging demands of the business’s customers
- Free up the cash flow of the company
- Share the business risks
- Give the business a competitive advantage - increase productivity in all the areas of the business
- Outsourcing can help the organization cut its operational costs by 50% if not more

Disadvantages

- While outsourcing services such as payroll processing services and tax preparation services, the outsourcing provider will be able to see the company’s confidential information and hence there is a threat to security and confidentiality in outsourcing
- When a company begins to outsource its business processes, it might find it difficult to manage the offshore provider when compared to managing processes within its organisation
- Offshoring can create potential redundancies for the organisation and the employees might express lack of interest or lack of quality at work
- The outsourcing provider might not be providing services only for one particular organization. Since the provider might be catering to the needs of several companies, they will not be able to give a particular company 100% attention
- Outsourcing, though cost-effective, might have hidden costs, such as the legal costs incurred while signing a contract between companies. The company might also have to spend a lot of time and effort in getting the contract signed
- With outsourcing, the organisation might suffer from a lack of customer focus
- There can be several disadvantages, such as, renewing contracts, misunderstanding of the contract, lack of communication, poor quality and delayed services amongst others
New concepts

A new approach: glh Hotels

2012 was a time of change at glh hotels, the company employed Mike DeNoma as its new CEO and to demonstrate the commitment to change, chief executive Mike DeNoma has renamed the company GLH, and revealed three new hotel brands (Clermont, Amba and Every) through the rest of 2013/14.

When DeNoma joined GuocoLeisure he was given an agenda to transform the hotel business of the Singapore and New Zealand listed group. As an outsider with experience in consumer goods and banking, he said the hospitality business appeared ripe for change.

He says the way forward will involve re-empowering general management and hotel staff to drive the guest experience; and there will be steps to rebalance what he sees as an unequal relationship between owners and the brands.

"The most fundamental thing was the waste of human capital – it was shocking. The industry had not changed as fast as the world around it." DeNoma said many in the sector fail to appreciate the concept of economic profit. "I was the only one laying awake at night figuring out how to double it."

For too long, the hotel industry has concentrated decision making at head office, says DeNoma. "We've turned the whole model on its head. Let's put more general managers back into the property than ever before."

In 2012, the company evaluated the brands and realised that they were very much a “poor cousin reproduction”. At the time the company operated two brands Guoman Hotels and Thistle. It owned 15 hotels in central London and managed a further 20 across the UK.

The company reviewed the brands and found the following:

- The Thistle brand was tired and burdened with entrenched (and limited) customer expectations
- Expensive refits (Cumberland, Grosvenor et al) had not reset customer expectations enough to earn a return on investment
- The company had a weak pale-imitation distribution infrastructure – inefficient CRO, second hand sales force, plywood digital footprint – with never any prospect of competitive advantage from any of them.
- As a result the company was under-performing – and perhaps even ossifying – in a rapidly evolving industry

DeNoma and his team decided that they needed to try something a bit different – more like a complete reset across the board:

- A reset of the guest experience
- An organisational transformation
- A technology transformation

So all at the same time the company rebranded, both corporate (ghl) and guest facing (Amba, every, Clermont, thistle express), all of which have been researched and highly targeted. But what was also important was the fact of rebranding itself, reset guest and employee expectations of the experience and of the company.

Ghl also realised that its future was in transforming the hotels it owned in London and it offloaded the managed properties outside of London.

The changes have been broad-based and multi-faceted, but there are four ‘hotspots’ that have been central to accelerating change:
Hotel wifi

The company invested in building out and owning the fibre core of the hotels in order to wifi-enable the envelope of the building with superfast broadband everywhere. The result is not just fast, free wifi, but is also a digitised building, which the company is discovering more and more is a different basis of competition:

- It enables them to curate individual rooms physically – and to sell and manage its stock of 5,000 central London rooms individually
- It enables staff to seamlessly follow guest’s demand through the day transforming productivity and guest satisfaction together
- Enables the company to digitise the relationship with the customer from the hotel backwards – not the booking journey forwards.

Warmth

Tripadvisor rankings for the individual hotels have been transformed, as guests have started advocating their stay experience. In the comments they make it obvious that is it less to do with the hotel refit and more the warmth of the staff driving the advocacy. This is turn has been driven by the focus on radical hosting – focusing on “its your house” and doing what it takes to make guests feel welcome, and the Value Centre General Management (VCRM) guest calling – personally connecting with guests before or during their stay to make a personal contact and ensure their needs are being met. Predictive analytics and ‘taste graphs’ are now helping VCRMs anticipate individual guest needs.

General Management

The company felt that the hotel industry is currently run by General Managers (GMs), but below them tend to be large functional fiefdoms; and above them, at Head Office, functional specialisms also seem to dominate; and the misaligned interests are exacerbated by the structural split between hotel operator, brand owner and hotel owner.

The results are that hotels are increasingly ‘de-skilled’ by chains swallowing decision making authority away centrally and functional silos are ill-equipped to make business tradeoffs on guest experience, pricing, sales and account development.

ghl wanted to reverse that, so it added a layer of VCRM below the GMs and delegated authority back to them for guest experience, pricing, marketing and selling etc. The results so far have led to more initiative and proactiivity at the hotels, more ideas and ideation everywhere, a massive 75% reduction in head office headcount and a whole new runway for business improvement through decision science.

Mobile/Cloud

The company also focused upon technological –re-architecting that honed in on mobile applications for staff and guests; and a move to the cloud. The company is now 95% cloud based and will turn its last server off during this financial year.

ghl has also moved to collaboration tools. It has replaced Microsoft Office with google tools etc. This has made the company much more production, always on, always collaborating and completely scalable.

Results

- So far results have been encouraging with top quartile profit growth of > 60% per annum
- Transformed tripadvisor rankings, particularly in rebranded hotels
- Accelerating momentum – profit, guest experience, talent, portfolio
Property technology

Internet of Things

The Internet of Things (IoT) is defined as “the interconnection of uniquely identifiable embedded computing devices within the existing Internet infrastructure. Typically, IoT is expected to offer advanced connectivity of devices, systems, and services that goes beyond machine-to-machine communications (M2M) and covers a variety of protocols, domains, and applications. The interconnection of these embedded devices is expected to usher in automation in nearly all fields. 38

Gartner predicts that there will be 26 billion IoT connected devices by 2020. Hence, the adoption of IoT technologies is going to be very quick in the coming years - so many of devices that are put into hotels will be enabled with IoT capabilities. Key hotel mechanical systems like air conditioning, elevators, heaters, thermostats, water chillers, sprinkler systems and more will eventually offer IoT enabled models. However, even simple systems like light bulbs, electrical switches and electrical plugs will eventually be IoT enabled.

Some examples of where IoT can used within the hotel includes39:

Energy Management: Despite efforts to make hotels green with compact florescent bulbs, LED lights, and low flow toilets, hotels still use a considerable amount of energy. Especially given that guests can do nearly anything and the hotel is unaware. IoT could help improve energy management by:

- An IoT enabled power socket could report power usage to the front desk / housekeeping when a power outlet has exceeded a set limit for power consumption over a period of time. This would enable maintenance or housekeeping to go investigate whether there is a problem with something that is plugged in to that outlet.
- An IoT enabled light bulb with a motion sensor and ambient light sensor could be programmed to go into a low power setting when light conditions are bright enough that light is not required. Furthermore, this could be adapted for a night time setting that would dim the light until motion is detected and then turn on to the higher power setting to provide additional light.

Environmental Monitoring: in the context of hotels this tends to focus on heating and cooling. IoT enabled devices will certainly help with these important tasks, but, there are new applications they could enable.

- An IoT enabled device with decibel monitoring capabilities could listen for and proactively report the location of loud noises that might be disturbing guests.
- A more sophisticated sound monitoring IoT device could analyse a noise pattern and identify the sound consistent with that of an overflowing sink/bathtub/toilet, or, an unauthorized pet in a room.

Building Automation & Monitoring: As new heating, ventilation and air conditioning (HVAC) models and elevator controls come on the market, many of the more advanced ones are likely to have IoT capabilities that will benefit hotel operations.

- An IoT enabled elevator could send out an error code to the local OTIS, ThyssenKrup or Schindler service centre and a technician could be despatched before anyone at the hotel notices a problem.

38 www.wikipedia.com
Similarly, a HVAC system that is IoT enabled could report a motor that is showing signs of failing and report it to the maintenance department.\(^{40}\)

There is no question that the IoT can make a hotel more efficient. The harmonising of sensors, devices and data all brought together in one system, enables the system to respond quickly to improve efficiency. It can also respond quickly to change temperatures, switch lights on or off etc, which in turn bring cost savings to the business.

IoT can also enhance the personal experience of customers. The hotels industry is well placed to benefit from the coming together of IoT and digital transformation. IoT deployments can serve as an essential competitive differentiator as it has a broad and easily recognised impact on hotels, spanning services including entertainment, food and beverage, guest security and many others.

For example a guest could use his/her smartphone as the door key, or a tablet to order food or book hotel services. It could also be used to set the temperature to the right level for when you arrive at your rooms and the lights come on seconds before the door is unlocked.

For hotels and resorts, differentiating in this area is not generally well-served by a cookie-cutter approach, as IoT technology has to be fashioned to meet distinctive differences of each facility and cater to guests in a customized fashion based on who they are and what they aspire to accomplish during their stay.

HOSPA (Hospitality Professionals Association for Finance, Revenue Management and IT) makes a very valid comment though – “the hospitality industry should aim to benefit from the IoT as it is on the forefront of utilising it to enhance the guest experience and increase operational efficiency. But first let’s sort out decent free Wi-fi in all hotels – and then we can get to ‘The Internet of Hotel Things’...perhaps?”\(^{41}\)

### In-room offerings

**Tablets and smartphones** are not only the personal instruments of the guests, but also on a regular basis, they are used as part of the in-room technology, either augmenting and consolidating, or replacing certain traditional items.

For example, hotels are using these devices to replace or supplement guest directories, photo albums, currency exchange boards, room service menus with ordering function, TV remotes with electronic programme guides, Blu-ray and DVD remotes, music portals, thermostats, lighting controls, curtains and blinds controller, telephones, promotions, weather, flight information and the list goes on.

In making the tablet a second screen to the TV, it allows the guest to have entertainment anywhere in the hotels, if then are connected to wifi.

These devices can provide quick, up-to-date information for the user rather than going through masses of printed material left in the room. These devices are also fun to use, cost effective to implement and easy to maintain and there is a huge trade off with printing and printed materials replacement costs.

Going forward, this technology will likely evolve into an in-house created app. The guest will be able to download it on their own device and use to functions to make their stay easier. This reduces capital expenditure for the

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\(^{41}\) HOSPA Voice – The Internet of Hotel Things
Franchise and Management contracts

Hotel Management Agreements

In a management contract, the operator manages the hotel on behalf of the owner and is compensated through a management fee, which typically consists of a base fee (a percentage of revenues of the hotel) and an incentive element (based on the profits of the hotel). The owner retains all profits after the management fees have been paid, but relinquishes day-to-day operational control. Management contracts are typically between 15 and 20 years in duration. Under a management contract, the total fee income is typically 8-10%.

Under a management contract, the hotel contract supervises:

- The overall operation of the hotel according to the company and brand standards.
- The day-to-day running of the business.
- Hotel administration.
- The performance of managers and employees including training and employment.

The company’s revenue from a management contract consists of:

- A base fee, usually a percentage of gross revenues.
- Management/Incentive fee based on a percentage of (adjusted) gross operating profit.
- Marketing fee based on rooms revenue.
- Reservation fee based on the number of reservations made.

The hotel owner is responsible for all investments, costs of the hotel including maintenance and repair as well as insurance. Hotels under management contracts typically yield EBITDA margins around 70-80%.

Key issues for owners when negotiating a Hotel Management Agreement

These issues are not exhaustive however and professional advice should be sought in each case. The crucial point is to ensure that the Agreement properly reflects the particular circumstances of the hotel.

Control and Key Performance Indicators: Two of the main purposes of the Agreement are clearly to free up the owner from the running of the business and provide the operator with the rights, powers and authorities it needs to make a success of the business. However, those rights should not be unchecked and an owner (even one that is looking for a “light touch” of control) should always look to build in appropriate protections. Those protections can vary depending upon the nature of the hotel's business but will typically include:

- a budget approval mechanism, with clear resolution procedures if the budget cannot be agreed;
- review meetings at appropriately regular intervals;
- a sensible process for agreeing the accounts of the business (which will be particularly important for calculating the fees);
- protections against certain types of loss, where this has been caused by the owner;
- a list of reserved matters that require the owner’s consent (while not interfering with the operator’s day to day running of the business). Bespoke matters relating to the particular hotel should always be considered, together with the more usual ones that are generally accepted in the hotel and leisure sectors.

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50 Global Hotel Perspectives 2014
51 http://www.dwf.co.uk/news/view-point/hotel-management-agreements-key-issues-for-owners
Additionally, KPI’s are often included to help measure, evaluate and control the operator’s performance. In particularly serious situations, KPI’s can be used by the owner to remove an underperforming operator. However, it is important that such termination rights are very carefully drafted to ensure they are practical and do not harm the underlying business.

**Fees:** One of the most important controls is ensuring that the fee structure is correct. The Agreement should have clear and achievable commercial incentives so that both parties are pulling in the same direction.

There are many types of fee structures used in Hotel Management Agreements but typically the fees can be put into three broad categories:

- a fixed fee or one based on a percentage of turnover;
- an incentive fee based upon the profit of the business;
- other charges relating to e.g. marketing services, reservation systems and certain licences.

Fixed fees or ones based on a percentage of turnover are relatively standard but it may well be that operators are willing to forego higher fixed / turnover fees, if they can secure longer terms and/or more attractive incentive fees.

Incentive fees sit alongside the fixed fee arrangement but will be more detailed. They can take many forms and be based upon different measures of profit (often Adjusted Gross Operating Profit or a form of Net Operating Profit). The percentage of such fees may also rise during the term of the Agreement if there is appropriate commercial justification for doing so. The detail of the drafting is clearly important and the calculations and definitions should be carefully checked, e.g. to ensure that they properly allocate which costs are operating costs and which are ownership costs.

The final types of charges mentioned above (i.e. relating to other specific skills, services and assets of the operator) are often linked to rooms revenue but again should be checked to ensure they are suitable and are not already reflected in the other fees.

**Guarantees:** Sometime operators still offer to guarantee a certain level of profit. While this may seem attractive to an owner, the terms of it should be carefully considered as often a higher fee is attached to such a guarantee.

**Term, renewal periods and exit:** The initial term of a Hotel Management Agreement will vary from case to case, often due to the respective bargaining positions of the parties. A more-established operator will generally look for, and be able to secure, a longer initial period. Nevertheless, the owner should be comfortable that the fees properly reflect any unusually long initial period.

Renewal periods (e.g. for subsequent 5 year periods) are commonly set out in the Agreement, although will usually require both sides to agree the renewal at the relevant time.

Owners should also be careful that the Agreement does not frustrate their ability to exit should a suitable opportunity arise. The processes for allowing such exits can require detailed negotiation and drafting to ensure that both parties are comfortable with the position.

**Third party issues:** A Hotel Management Agreement should not be considered in isolation. Frequently, Leases and Franchise Agreements, as well as other funding and commercial agreements, will be involved and the Hotel Management Agreement should appropriately dovetail with them. Such agreements should also be checked for any relevant consents that may be required (and the obtaining of those worked into the timescale of the operator commencing its management of the business).
## Differences between Franchise Agreements and Management Agreements

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<th>Franchise Agreements</th>
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| **What is granted?**                       | Hotel owner is licenced a package of IPRs, essentially relating to the brand of the operator. These IPRs are to be used in the management and operation of the hotel. Centralised marketing, advertising and reservation services are provided for a further fee. Management and operation of the hotel remains the obligation of the owner.                                                                                                                                                                                                                                                                                                                                                                           | Operator will:  
- Manage and operate the hotel on behalf of the owner;  
- Provide technical services (e.g. in relation to the design and development of the hotel);  
- Licence its brand  
- Provide centralised advertising, marketing and reservation services. Clearly under this structure the hotel benefits from the “hands on” experience of the operator.                                                                                                                                                                                                                                               |
| **What are the owner’s obligations?**      | Whilst the overall management of the hotel remains with the owner, the owner is required to:  
- adhere to the operator’s brand standards manual  
- participate in group marketing and advertising  
- participate in the group’s reservation system  
- open the hotel on a specified date  
- prepare and maintain records and accounts to be shared with the operator  
- comply with all legal requirements and provide the operator/franchisor with protection against any claims                                                                                                                                                                                                                                                                                                                                                                          | Although management and operation of the hotel is provided by the operator; the owner will remain responsible for:  
- compliance of the hotels with the operator’s brand standards (and the cost of renovations associated with them)  
- Cost of maintenance and repairs  
- Insurances  
- Employment of non-management employees  
- In some cases obtain licences  
- Real estate issues  
- Some owners will seek the right to approve annual budgets, capital and FF&E budgets, approve key personnel positions, review accounts etc.                                                                                                                                                                                                                                                                                                                                   |
| **What is provided by the operator?**      | Training on the operation of the hotel according to the ‘system’ (some training may be incorporated in fees, some may involve additional charges);  
- Providing and updating the brand standards manual;  
- Occasional pre-opening services;  
- Access to the operator’s marketing, advertising and reservations system;  
- Technical services may be provided for other areas albeit this is likely to be for additional fees                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | The operator will typically:  
- Operate the hotel to brand standards  
- Include the hotel in the operator’s marketing, advertising and reservations systems;  
- Have the authority to conduct day-to-day operation of the hotel including purchasing goods and services, conducting litigation, managing staff etc.;  
- Provide technical services relating to the design and development of the hotel (this is often subject to a separate fee).                                                                                                                                                                                                                                                                                                                                   |
| **What are the fee structures?**           | A typical fee structure involves:  
- An initial fee (this is often linked to the size of the hotel). In some cases this fee is non-refundable.  
- Continuing or royalty fees – this is based on room revenue. Typically this is between 3% and 5% of room revenue;  
- Advertising/marketing contribution – also based on room revenue. This fee generally goes towards a fund for group (not necessarily local or regional) marketing. Typically between 2% to 4% of room revenue;  
- Reservation                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | A typical fee structure involves:  
- "Base fee" typically between 2% and 4% of gross revenues;  
- "Incentive fee" typically around 10% of gross operating profit;  
- Technical services fees – lump sum or payable on time and materials basis for relevant services;  
- Centralised services fees – often made up of:  
- Marketing fees – typically in the region of 2% of room revenues  
- Reservation fees – calculated per room or against room revenue  
- Loyalty and other programmes provided                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| **Standards applicable**                   | Hotel operations commonly have a brand standards manual or operating manual. Compliance is key.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Brand standards manual. Compliance is key                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
Procurement

Introduction

The role of procurement in a hotel operation is not immediately apparent. However, procurement costs are a core part of the hotel profitability.

There is a difference between procurement and purchasing. Procurement as a function is much bigger in scope than the traditional purchasing function.

Purchasing refers to the process of ordering and receiving goods and services. It is a part of the bigger procurement process. Generally, purchasing refers to the process involved in ordering goods and services, such as request, approval and creation of a purchase order record and ultimately the receipt of goods.

On the other hand, procurement is the function that describes the activities and processes to acquire goods and services. Key to this and clearly different from purchasing, procurement involves among others:

- Sourcing activities such as market research
- Vendor evaluation
- Negotiation of contracts

It also includes purchasing activities required to order and receive goods.

Moreover, it could be said that the procurement function consists of a complete mechanism that includes processes closely involved with the vendor community, goods and services markets and the world of contracts.

Also the procurement function for a group of hotels takes on a completely different meaning as compared to the function for a standalone hotel. The procurement function for an operating hotels is also different from that of an opening hotel.

With purchases typically accounting for 35% of the average hotel’s turnover, securing the right combination of price quality and service from vendors is a key factor in conversion delivery.

Management companies offer a complete procurement service covering all revenue and capital commodities necessary for the fit-out and day-to-day running of a hotel.

The big three revenue items – Food, drink and laundry which, when combined, typically account for 50% of the procurement spend.

Procurement costs

Procurement costs can broadly be of two kinds:

- Those that are adding to the cost of the product or service being acquired. All those costs that are incurred to bring the items to the place of use. This includes transportation, freight, insurance customs duties and so forth. In this way these costs are part of the procurement process. The key criterion here is that these costs are directly identifiable with the goods or services being acquired.
- The costs of running the procurement function. The other kind of procurement cost is the cost of running the procurement function itself. These are salaries, wages and benefits of employees working in the department, their bonuses, increments, cost of supplies used, for example the stationery like purchase orders (if these are still in paper), cost of the purchasing system which is used to administer the function and so on. The purchasing system (electronic) is normally part of the Inventory and receiving functions.