LODGING HOSPITALITY IDEAS FOR HOTEL DEVELOPERS & OPERATORS

Is Outsourcing the Answer for Hotel F&B?

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Consider All the Alternatives and Determine What Adds the Most Long-Term Value

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Asset managers are engaged to optimize hotel investment returns. The discipline focuses not only on the strategic decisions of acquisition and divestment timing but also how to derive maximum profitability out of every operating department within a given property by enhancing revenue and reducing costs. A new book published by the AH&LA Educational Institute (http://www.ahlei.org/) , Hotel Investments Issues & Perspectives, *provides a current and comprehensive overview of the latest trends in maximizing hotel investment performance through the eyes of industry leaders, including asset managers, consultants and operators. Six of the chapters are being presented as part of ALIS University, a workshop series that will be featured at the 2012 ALIS (http://www.alisconference.com/) conference later this month in Los Angeles. One chapter is on food and beverage, specifically leveraging partnerships for improved profitability.*

Hoteliers have long struggled with what to do with food and beverage. Is it a profit center, an enticement to book a meeting, or a necessary evil? Regardless of your opinion, f&b typically accounts for more than one-fourth of a full-service hotel's revenues and has an ever-expanding role in limited-service properties. The food and beverage department typically represents a significant opportunity to enhance a hotel's profitability, value and investment returns.

A substantial number of hoteliers have determined f&b is not their core competency and are investigating outsourcing a portion, if not all, of the responsibility of this function to boost profitability. While putting a troublesome department or outlet into someone else's hands may be the ideal solution for some hotels, it also may result in some unintended consequences. Here are some key factors asset managers and owners consider when determining if partnering with an outside restaurateur is the right choice for a property:

Market positioning. While it seems simple, matching the f&b outlets to the hotel's "personality" can be complex. The two should complement one another so the f&b enhances, rather than distracts from the hotel experience.

People issues. Understanding the potential impact of changes to existing food and beverage operations is critical to identifying opportunities within the context of a labor agreement. It's in the interest of both operator and the union to work harmoniously toward solutions to remain profitable and preserve jobs.

Brand standards. Brands have shown more flexibility and support in recent years in accepting alternative solutions for meeting standards in f&b. However, don't get too far down the planning process before consulting your brand to avoid costly do-overs.

Physical plant. A great restaurant needs a great kitchen and a logical layout. Identifying challenges and constraints posed by the hotel's physical structure will assist in determining partnering options.

Anticipated investment horizon. The decision to partner requires a commitment that typically ranges from 10 to 15 years or possibly more. Approach it like a commitment to marriage and remember "divorces" can be painful and costly.

Capital resources. In nearly all cases, the decision to partner will require the owner to participate in a capital investment. Assessing capital resources and the level to which an owner is willing to invest are major considerations.

Competitive market. Analyzing the competitive landscape within the immediate market area is important to ruling out potential concepts that may already exist, as well as identifying opportunities to fulfill a local need.

Once the decision has been made to move forward with a third-party f&b partner, there are a number of business models to consider:

License agreement. A license agreement, or franchise, is the simplest form of partnership. Hotel owners assume 100% of the risk; the typical license agreement term is five to 10 years and costs somewhere in the range of 5-8% of revenue, plus an initial fee.

Lease agreement. A lease allows the restaurateur to operate a predetermined food and beverage outlet within a designated space in a hotel. It sets a locked-in return for the hotel— typically calculated as a percentage of sales, averaging between 6% and 10% of gross revenues, with a guaranteed base rent minimum. Typical lease terms are at least 10 years. Major risk factors: a) creditworthiness of the tenant; b) shelf-life of the concept; c) expense associated with the build-out; and, d) relinquishing full control of a guest experience to a third-party operator.

Third-party operating agreement. Similar to a third-party hotel management company, the hotel pays a management fee, typically ranging from 3% to 6%, to the operator, and in most cases an incentive fee is negotiated and paid when specific financial targets are achieved. The hotel maintains more control over the operation than in a straight lease scenario, sharing fully in the financial upside, while also bearing 100% of the expenses and related financial risk associated with the operation.

Hybrid. Hybrid, or blended, structures are typically born out of circumstances at the hotel which necessitate a modification to a prototypical arrangement. Hybrid arrangements are the most complex form of food and beverage partnership, as they typically include a highly creative structure, close operating coordination and custom accounting solutions.

Before you make a decision to keep f&b or outsource it, consider all the alternatives and determine which adds the most value, not only for today, but for the long-term.

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