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Opinions

How to mitigate FF&E risk in today's CapEx environment

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There's more to a successful CapEx project than hiring a purchasing agent and a contractor.

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During 2020, the hospitality industry will undertake a record number of CapEx projects, estimated at more than $7 billion. This volume, combined with an expanding global economy, trade wars and numerous unpredictable events, puts CapEx projects at greater risk.

Given this volume, what are the key things every owner should focus on to reduce project risk and reap the greatest rewards, from initial planning through final project closeout?

While it seems obvious, the most important task is to assemble the best team. Selecting the key team members, defining their roles with a clear responsibilities matrix and then sharing the project's goals, schedule and budget is critical to success. On a typical project, this team will be working together for the next 12 to 36 months. The right decision here impacts every aspect moving forward.

Like a sports team, a hotel's project team is only as good as its weakest link. Call references and allocate the time to perform thorough due diligence. Additionally, it is critical to understand each consultant's business model and its total source of compensation for the services provided. Transparency is imperative.

The hiring of the contractor, architect and design firm precede the engagement of the procurement firm for furniture, fixtures and equipment (FF&E) and operating supplies and equipment (OS&E). The logistics firm, warehouse and installer follow that process, putting the purchasing agent in a pivotal "communication central" role.

Over the years, the purchasing firm's responsibilities have expanded significantly from one of sourcing, bidding, ordering and expediting to a much larger role that I define as risk manager. While this is a term often associated with investment banking and global trading, it also applies to the role of a purchasing agent. This risk management ranges from seamlessly dealing with the well-publicized China tariffs to weather disasters and sales tax issues.

Even sourcing has changed dramatically in recent years. Today, it is truly global, and even a "domestic" vendor relies on a global supply chain for raw materials and component parts.

When an unpredicted weather or natural disaster occurs, much more than the directly hit region is affected. The supply chain ramifications are vast and often long lasting. The purchasing agent must be able to respond to weather problems, as well as the constantly changing business risk, currency risk and political risk throughout the world.

On a spec-by-spec basis, the purchasing agent has to determine and understand every product and each vendor's performance history. Potential risks range from factory location to something as simple as a holiday. The Chinese New Year is well known, but many other countries have national and regional holidays, some of which can delay production from a day to weeks.

The purchasing agent must also evaluate the terms of sale, respective warranties, packaging materials used, how a product will be shipped and other vendor-by-vendor specific information. An incorrect shipping-related decision can delay a hotel opening by days and sometimes weeks.

As the owner's fiduciary, a purchasing agent must evaluate each vendor well beyond simply a cost on a spreadsheet. Additional risk factors include working with the logistics firm to verify a trucking company's safety rating, double checking that a furniture spec will fit in the hotel elevator or confirming new, energy-efficient lightbulbs are consistent with the existing sockets.

These are just a few of the "behind the scenes" tasks the purchasing agent performs on every project. Note, that because of many changing factors (foremost today being lead time and vendor capacity), specific vendor recommendations for similar specifications may change in under a 30-day time frame.

In addition to managing the apparent and immediate risks during the procurement process, the purchasing firm must also focus intently on reducing the risk years after the project has been completed. For example, there can be a substantial penalty in a tax audit if the purchasing agent can't provide the "where did every dollar go" answer.

Globally, governments are struggling to find new tax revenue. Verify that your purchasing agent has a well-versed project accounting team that can correctly handle sales tax accruals and as applicable, tax on freight, professional fees and customs/duties specific to each region in the world.

The purchasing agent's measure of success and true added value continues even after the projects are delivered with budget and schedule integrity. We often receive our highest praise from clients three or four years after projects are completed and owners face an unplanned sales tax audit. Our standard is to have every single order and invoice accurately and correctly detailed and no penalties are incurred. This is an area of risk management that often is overlooked by those focused only on getting a project completed.

While no owner hires a purchasing firm to spend more money, the role of purchasing agent has expanded greatly beyond "we can get that for you cheaper." From short-term vendor analysis, to future tax audit confidence, make sure you select the firm that will manage all the inherent risks in any project at the highest level possible.

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