

# GROWTH THROUGH MANAGEMENT

by Rick Swig, ISHC

Whether or not public companies which are owners of hotel real estate will continue their growth through merger and acquisitions remains to be seen. The screeching halt to trading of hotel real estate in the third quarter of 1998 coupled with stock prices fall off the cliff last August, certainly signaled Wall Street's uncertainty about the potential for growth in the hotel sector. Ironically, since that time, however, the hotel business from an operating standpoint has continued to prosper. Operating cash flows are still at a historical pinnacle.

As many have predicted, there will be somewhat of an operating slow down in 1999, which should really be considered a stabilization. Hotel occupancy and average daily rate trends are returning to the normal ebbs and flows which have represented a "standard" market pattern in past decades. A "standard" market pattern would consider historical seasonal occupancy patterns, impact from the annual rotation of meetings and conventions, and the normal course of demand from leisure and corporate markets.

The 1990's have yet to exhibit any "standard" market patterns. The first five years featured a crash into an abyss, the struggle to heal the damage, and the strategy to find a way out. After emergence from the depths of depression, the last three years in many markets have reflected a shooting star with glowing growth in REVPAR and profitability.

Development in the limited service segment showed tendencies for the industry to once again enter into a morass of overbuilding. The gathering momentum for increased development in full service sector was however stifled or at least restrained in 1998 by the change in favor from the public markets and other capital sources.

As 1999 begins, the hotel industry will regroup. Capital markets and lender segments which must continue to invest at least for the sake of their own growth will determine the process that will allow participation in the hotel real estate segment. Just how much discipline and restraint will be exhibited remains to be seen. Parameters for lending on existing properties and portfolio should revert to historical cash flow considerations. Investment related to new construction should place greater risk burden on the developer with much more conservative views on forecasted cash flow potential.

The public companies must exhibit aggressive strategies for greater growth of cash flow through expense minded hotel operations and corporate overhead. Starwood Lodging set a great example

for the industry by collapsing three corporate structures into a workable model. Managed hotels began to share single platforms of marketing, reservations, frequent guest programs, human resources, purchasing, operational oversight, accounting, and other disciplines. These emerged from taking the best practices from each of the three merged companies.

There are several perceived risks and rewards of corporate streamlining, especially when multiple brands and management for outside owners are involved. The combining of areas like accounting and human resources are the most simple to analyze. Standardization in these areas creates significant cost benefits and operational efficiencies, if only in the area of training where the communication both verbally and technologically is limited to one language and a single set of standards and practices. The interpretation of standards and practices becomes globally interchangeable between all hotels and related personnel, while the collection, analysis, and transmission of data, whether related to financial or human resources trends become a manageable and coordinated exercise.

The notions of combined management oversight, marketing and reservations efforts have borne significantly more scrutiny, especially as the issues of geographic protectionism in management contracts and historical competitive positioning are involved. The rising concerns have included among others the following:

- Is the competitive strength of a brand being protected when its marketing and distribution functions are being corporately combined?
- Do the combined marketing efforts of two brands strengthen historical competitive positions and business opportunities through expanded human resources, customer data, and referral opportunities or does it weaken any individual hotel's competitive position?
- Do combined distribution channels (i.e. central reservations operations) create more business opportunities through overflow referrals or lower the traditional competitive barriers between brands?
- Will an interchangeable frequent guest program bring increased customer traffic or initiate brand switching to the benefit of one product or another?

To be sure there are significant cost savings by reducing redundant corporate departments and maximizing the benefit of critical mass and geographic coverage. Certainly, there are some quantifiable hotel owner and customer benefits. Whether these also give way to a sacrifice or a strengthening of brand differentiation and product impact remains to be seen.

Other public companies which are the result of mergers and acquisitions should follow a similar path towards more efficient and effective corporate operations. In tandem with expense management in hotel operations, this moves both towards establishing a definable corporate culture and realizing more profitability at both individual hotel and corporate levels.

The boom of the 1990 s is over. Global and national economic trends will dictate whether any radical downward revenue trends will take place, but for now the most optimistic viewpoint seems to be a move back towards a "standard" pattern with unexciting but steady growth in average daily rate and reasonable fluctuations in occupancy. With this normalization private and public owners must continue to discover new strategies and implementations to expand growth in profitability beyond that of revenue.