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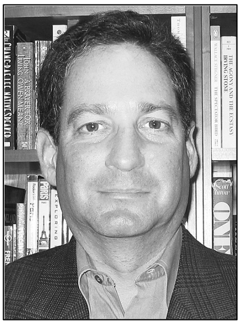
Managing the Manager: The Owner–Management Company Relationship

By Bruce F. Stemerman



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Before joining CHM, Mr. Stemerman held various positions over a 15-year span with Marriott International and then Host Marriott Corporation, where he served as Senior Vice President, Asset Management. In that role, he led a group of asset managers responsible for all ownership aspects of Host's portfolio of 125 upscale and luxury hotel properties with nearly 60,000 rooms.

Mr. Stemerman is the immediate past president of the Hospitality Asset Managers Association (HAMA) and a long-term member of HAMA's board. In addition, he serves on the Advisory Board of Madison Hotel Opportunity Partners, LLC, a fund focused on financing and acquisition opportunities within the full-service segment of the hospitality industry. He also serves on the Board of Co-Owners of Camelback Inn, Scottsdale, Arizona. Before joining Marriott in 1989, Mr. Stemerman was with Price Waterhouse in their New York and Washington, DC, offices. He graduated from Rochester Institute of Technology and is a Certified Public Accountant.

REAL ESTATE is one of the most dynamic and enticing businesses in our capitalistic society. Much of the great wealth accumulated in this country has its origins in the development, ownership, and management of real estate. While the office, retail, and residential segments all have their challenges and rewards, most view lodging as the most diverse, complex, and multi-dimensional of real estate asset classes.

Our inventory—the guestroom—is perishable, expiring on a daily basis, and therefore must be actively and even scientifically managed to yield the best possible results. Full-service hotels offer food-and-beverage outlets, banquet services, fitness facilities, retail outlets, and, in some cases, spas, golf courses, and much more. Economic and competitive cycles create an ever-changing dynamic that must be proactively managed. It is this diversity and complexity that have drawn an increasing number of professional lodging asset managers to this business, and promise to continue to do so. To be successful in this environment, today's lodging asset manager must possess a well equipped toolbox of varied skills.

Today's Lodging Asset Manager

Within the asset management arena, the interest in and demand for skilled asset managers are increasing. As the nature of the hotel owner has evolved over the last two decades from a passive investor (e.g., institutions and real estate limited partnerships) to an active owner (e.g., public companies, including real estate investment trusts, and private equity funds), the importance of the lodging asset management function has grown considerably. Professional lodging asset managers are viewed as integral to an owner's efforts to maximize the value of lodging real estate. The focus on asset management has become more intense during the recent difficult economic times, as hotel owners have become even more determined to maximize returns and enhance the value of their hotels.

For most practicing asset managers in the profession, a substantial portion of their time and effort is spent dealing with the manager ownership has engaged to operate the hotel on a day-to-day basis. Even in the model where the entity owning lodging assets also manages those assets, companies have established an internal asset management function. These enterprises recognize the value of an independent asset management function and appreciate the alternative perspective and value-enhancement focus that a professional lodging asset manager brings to the dynamics of the owner-manager relationship.

The relationship between a hotel owner and the hotel manager is typically defined by the management agreement. As management contracts are discussed elsewhere in this book (see Chapters 5 and 6), it is sufficient to note here that they establish the fundamental terms of the relationship between the parties involved. The management agreement addresses the rights and obligations of the parties, compensation, services to be provided, the duration of the agreement, owner approval rights over capital investment and operating budgets, and a multitude of other terms and conditions. From both the owner's and the manager's perspectives, the management agreement is the key document setting forth each party's respective rights and responsibilities. Nothing in this chapter is intended to detract from the critical importance of the underlying document; however, in building an effective owner-manager relationship, the provisions of the management agreement are merely a starting point.

Managing the Owner-Manager Relationship

Building an effective relationship with the third-party manager of an owned hotel is essential to maximizing the value of the asset. The first step in building such a relationship is to align the interests of both parties. While this principle should be obvious, it bears emphasis: a key ingredient to any effective business relationship is a mutual understanding of how success is to be defined and measured. The parties must agree on the goals and objectives to be achieved if the venture is to be successful. Given the complexities of the lodging industry and, at times, the divergent interests of the owner and the manager, achieving a successful owner-manager relationship can be an endeavor fraught with challenges.

A Foundation for Success

The best relationships, in the business world as in our personal lives, are those that involve timely, honest, and open communication between the partners. Mutual respect, a clear understanding of objectives, and open lines of communication characterize an ideal relationship. This type of relationship has the greatest potential for success because everyone's efforts are focused and aligned to accomplish the same goals and objectives.

Fortunately, the goals and objectives of a hotel owner and a hotel manager are relatively well aligned from the start. Both parties want the hotel to be a commercial success. Since success in the business world is typically measured in dollars, this means that a hotel that maximizes the return on investment will be more highly valued. All other measures of success emanate from or contribute to the basic objective of maximizing return on investment. Both parties generally want the hotel to be successful compared with its competitive set—the half-dozen or so properties that it competes against most directly. Both want their guests to feel good about their experience in the hotel so they will not only return but will share their positive impressions with others so that they, too, will patronize the hotel. This natural alignment of interests provides a substantial foundation for potential success.

Often, the compensation of the hotel manager is designed to align the interests of the owner and the manager. In the typical management agreement, a portion of the manager's compensation is based on the hotel's gross revenues, while another, often significant, portion is determined as a share of the profits generated. Profits are "where the rubber hits the road" for owners. To the extent that the manager can generate meaningful fees from producing incremental profits, it is more likely that both parties' interests will be well aligned, moving along a common path.

The Strategic Plan

It is difficult—impossible, actually—to choose a path to follow if you do not know your destination. It seems simple, yet the misalignment of goals and objectives is a common reason for owner-manager relationships to go awry. An effective way to align interests is to develop a strategic plan for the hotel. This should be a collaborative effort between the asset manager and the hotel's property-management team, although the asset manager should lead the way. The strategic plan may take many forms but generally involves an assessment of the current state of the hotel and an identification of the hotel's strengths, weaknesses, opportunities, and threats—commonly referred to as a SWOT analysis. It cannot be emphasized enough that the asset manager should work collaboratively with the hotel management team in developing the SWOT analysis. This is the footing for the overall strategic plan. It is a critical opportunity for all of the stakeholders to focus on the hotel's problem areas, capital-investment needs, and competitive challenges. The strategic plan will identify strengths and opportunities that can be exploited to achieve greater success at the hotel. It also identifies weaknesses that ultimately will need to be overcome to maximize the hotel's value.

The strategic plan should also address the owner's intentions with respect to the hotel: Does ownership expect to hold the hotel indefinitely, or is there a plan to sell the asset in, say, the next three to five years? The ultimate disposition plan for the hotel is one of the most critical objectives for ownership, as it will want to position the hotel to yield the highest possible sales price. From the manager's point of view, a change in ownership can be daunting, for a number of reasons. The management contract may terminate upon a change in ownership, but even if the acquiring entity is locked into the contract or chooses to retain the current property-management company, it may have different views on adherence to brand standards or capital improvements at the hotel.

A strategic plan for a hotel asset that ownership intends to sell in a relatively short time (within less than five years) may create tension between the manager and the owner because the owner's priorities for value-creation opportunities will likely differ from the manager's objectives. For example, the owner might be more interested in extending the life of the guestroom furnishings, allocating funds instead to repairing the façade of the building. It is crucial that the asset manager work these differences out collaboratively and cooperatively with the manager, finding some middle ground that both parties can live with. At the end of the day, ownership needs the manager's "buy-in" to the strategic plan.

Once developed and documented, the strategic plan should be referred to regularly and adjusted based on changes in the economy and the competitive environment. As in the creation of the strategic plan, it is just as important that revisions be developed collaboratively to avoid future disagreements between the asset manager and the hotel manager. The strategic plan should be viewed as a "living" document that needs regular attention and nurturing.

Action plans for the accomplishment of the goals set forth in the strategic plan must be developed with specific milestones, and these action plans must be periodically reviewed, assessed, and updated. Keep in mind that while the objectives set out in the strategic plan should be aggressive, they should also be viewed as being achievable. It will be difficult to keep the parties involved focused on objectives that are considered impossible to achieve.

Challenges and Opportunities

While the asset manager is focused exclusively on economics, the manager might have competing motivations. For first-tier, branded managers (as opposed to independent managers), the interests of the brand may also come into play. For example, brand standards might require certain capital expenditures that the owner would not otherwise consider productive investments. A similar conflict arises if the brand has an interest in developing additional product in the same market area where an owner's property is located. The owner may view the new product as adversely affecting the operating results of its existing hotel.

The preceding situations are only two of many examples where the owner and the manager might have different perspectives that may lead to conflict. There are no easy answers for resolving such differences, but it is important that the asset manager understand the manager's perspective and motivations. With regard to brand standards, for example, the manager should always be motivated by the desire to gain preference for the flag's product among customers, but she must also be able to demonstrate clearly to ownership the economic or competitive benefits of each initiative proposed. It is the asset manager's responsibility to require an economics-driven business case that supports any initiative proposed by the manager. If a cogent business case is consistently required, the manager will ultimately provide one automatically with every proposal submitted. In many cases, the asset manager should participate in and guide the preparation of the business case so the needs of ownership are met.

Many of the best value-additive opportunities originate from the hotel's property-management team. An effective asset manager encourages the general manager and the property-management team to suggest opportunities frequently. By creating a collaborative environment where new and creative ideas and opportunities are welcomed—even expected—the asset manager can considerably advance the sense of partnership with the property-management team. It is also likely that many of the opportunities that the general manager or other members of the executive committee propose will yield meaningful results. The asset manager who discourages or dismisses such proposals will not only foreclose potential opportunities, but will also foster an environment of disengagement among the hotel executive team.

Communicating More

It is also crucial for the asset manager to ensure that the general manager knows all of ownership's expectations. The critical expectations will have been set forth in the strategic plan. But beyond that, the asset manager should clearly communicate the owner's desires regarding the frequency and content of communications, the level of detail to be contained in financial analyses, the manager's role at periodic owner-manager meetings, and all of the other expectations and nuances that will contribute to an effective ongoing relationship. Making the general manager aware of what the asset manager expects reduces the chances of disappointment and can greatly contribute to a solid working relationship.

Communication of expectations applies equally to the general manager, so the asset manager should solicit the general manager's views on his expectations from the relationship, and strive to accommodate them. Many of today's management-contract companies, particularly the largest ones, have varying chains of command. Therefore, it is crucial for the asset manager to understand any limits that might apply to the general manager's authority. If the asset manager is to achieve his objectives, it is likely that, in some instances, he will need to establish relationships beyond those at the property level.

As with all relationships, balance and an appropriate sharing of the rewards of success are critical for the long-term well-being of the relationship. If one party is viewed as reaping more than its fair share of the rewards, then the other party will ultimately seek to revise or end the relationship. Equity in a relationship is difficult to define. It is not surprising, therefore, that we have witnessed a power shift in recent years as owners have more aggressively and publicly exercised their rights, achieving a relationship they feel is more equitable. In the opinion of many, this shift has resulted in a more balanced sharing of rights between the owner and the manager. In light of the more active involvement of professional lodging asset managers, it is not surprising that owners have demanded and achieved greater influence regarding all aspects of the hotels they own. Some management companies have contributed to this power shift by being less than forthright in disclosing certain details of their stewardship. These instances have been well documented in the press and, as a result, most managers have adopted a much more open and transparent approach, sharing with their owners previously undisclosed information. Although this is a very positive development in the evolution of the owner-manager relationship, it is difficult to predict all of the consequences that this power shift may bring. Like all relationships, balance is important, and too great a shift in favor of ownership could yield a whole new set of challenges.

As the vignette presented in Exhibit 1 illustrates, some in our profession employ considerably more aggressive techniques in their efforts to enhance the value of their hotels. Aggressiveness, dedication, passion, and knowledge of the lodging business are attributes of a successful asset manager, but some employ more contentious and belligerent methods in their asset management efforts. This approach involves berating, belittling, and disparaging the general manager and his team, constantly invoking the lurking threat of litigation. Although this type of behavior can occasionally be effective, it is rarely successful over an extended period of time. More often, an overly aggressive and adversarial approach to the owner-manager relationship will lead to a misalignment between ownership's and management's goals and objectives for the property. A relationship in which there is a misalignment of interests will lack trust, and the inevitable disagreements will often escalate, becoming more serious problems that can be resolved only through litigation. Regrettably, there are times when litigation becomes a necessary course for a party, but it is also a clear sign of failure in the relationship and usually is not a productive path. It often causes harm to the hotel as financial resources and time are diverted to defending positions rather than to enhancing the value of the asset. The hotel's management team should view an effective asset manager as a partner, not as the enemy.

The Ideal General Manager

At the property level, the professional lodging asset manager's key point of contact with the management company is normally the general manager. (The title "general manager" is intended to refer to the most senior-level employee of the management company at the hotel, although the person in this role may in fact hold an alternative title such as "managing director.") The general manager is the person who can most influence the day-to-day results achieved by the hotel. In a perfect world, the management agreement would provide the hotel owner with approval rights over the hiring of the general manager, as well as the authority to remove the general manager for unacceptable performance. Among the many rights an owner might negotiate in a management agreement, the ability to hire or dismiss the general manager, even though rarely exercised, may be one of the most

Exhibit 1 A Tale of Two Asset Managers

Presented below are two very different approaches to setting up the annual budget-review process at comparable hotels.

The annual budget review process for both the **First Class Resort** and the **Upscale Resort** will occur in the next month. Both hotels are full-service luxury resorts located in the United States. Both have approximately 500 guestrooms, four food-and-beverage outlets, multiple retail outlets, a full-service spa, and an 18-hole championship golf course. Both are typically ranked among the top 50 resorts in the country and both enjoy premium market share when compared with their competitive sets. Both hotels have performed well in recent years, but have been adversely affected recently by a general downturn in the economy.

The hotels are owned by an institutional owner of a multi-billion-dollar portfolio of real estate that includes, among other asset classes, more than 20 hotels. The owner has assigned new asset managers to these hotels. **Carl Collaborative** is responsible for the First Class Resort and **Allan Adversarial** is the asset manager for the Upscale Resort.

Several weeks in advance of the budget-review process for the First Class Resort, Mr. Collaborative calls the hotel to introduce himself to the general manager. In the call, he expresses his excitement over becoming involved with the hotel and working with the general manager and his team. He provides the GM with the timetable for the budget review and suggests several alternative dates for the review session, which he anticipates will take two days and will involve members of the GM's executive team for portions of that time. He comments on some of the challenges facing the hotel in the upcoming year and stresses the need to work together in setting specific outcomes for the budget review. He gives the GM some overall objectives that the owner has for the hotel's economic performance in the next year and acknowledges that they will be difficult to achieve but that "we need to work together to accomplish these financial objectives." He provides the GM with a detailed proposed agenda for the meeting, seeks the GM's input and suggestions for other topics that should be covered, and solicits the GM's desired outcomes for the meeting. He also suggests that the meeting be used to update the hotel's strategic plan in light of current economic difficulties. He offers to spend some time at the beginning of the meeting to help the hotel management team better understand the owner's business strategy and perspective. Finally, he stresses the importance of working together during these difficult times, pointing out the critical role that the GM and his team will play in the continuing success of the First Class Resort. Both agree to speak at least weekly during the period leading up to the budget-review meeting to continue the planning process and avoid any unanticipated events.

Several weeks in advance of the budget review process for the Upscale Resort, Mr. Adversarial calls the hotel to introduce himself to the general manager. He tells the GM that things need to change, that the GM and his team are not focused on the right things and need to do a much better job managing the hotel or there will be consequences. "There's a new sheriff in town and things are going to change from now on." He instructs the GM to block one week for the budget review process and to clear his schedule and his executive team's schedule for the entire week. In response to the GM's request to discuss some critical capital-expenditure needs during the meeting, Mr. Adversarial responds that he will set the agenda and

(continued)

Exhibit 1 *(continued)*

does not need input from the GM or anyone else. He reminds the GM who owns the hotel. He provides the GM with a voluminous list of minutiae and analyses to be prepared in advance of the meeting. When the GM indicates that existing reports in slightly different formats will provide the requested information, Mr. Adversarial demands that new reports be prepared in the format he prefers. The GM also expresses his concern that, in light of the current volume of business at the hotel, it may be challenging to assemble all the requested information before the meeting. Mr. Adversarial informs him that "if you can't get it done, I'll find someone who can." He reminds the GM that he has the contractual right to have the GM fired, and that he will not hesitate to do so if the GM does not do everything he asks. In closing, Mr. Adversarial tells the GM to make sure the hotel limousine picks him up at the airport and that the Presidential Suite be reserved for his stay.

These are two very different approaches to performing the asset management role. If you were the GM of the Upscale Hotel, would Mr. Adversarial and his approach motivate you to achieve success?

powerful toward ensuring that the owner's and the manager's goals and objectives are aligned. It is encouraging to note that some of the more progressive management companies seek input from the asset manager in evaluating the general manager's performance.

Characteristics of the Ideal General Manager

There are certain characteristics the ideal general manager should possess, and it is important that the asset manager be aware of these characteristics in order to seek them out in a general manager. The characteristics of the ideal general manager generally fall into five categories: market expertise, operating results, capital expenditures, employee and community relations, and communication. It would be rare for any general manager to have achieved highly developed skills in all of these areas, but an effective asset manager should understand the strengths and weaknesses of the general manager. In this way, the asset manager can more appropriately focus attention where it will supplement the general manager's talents and add the most value.

Market Expertise. The ideal general manager understands the key demand drivers in the property's market. She knows who her customers are, who her competitors' customers are, and who her potential customers are. Marketing plans are developed to retain existing customers, obtain new customers, and attract customers from the competition. She is the consummate salesperson. The ideal general manager develops an effective marketing plan based on market conditions and motivates the property's sales team by setting specific goals. She understands and, more important, anticipates trends and changes in her market, and she reacts to these shifts before anyone else is even aware of them. The ideal general manager demonstrates great flexibility in reacting to market shifts and achieving balance among the various market segments served (group vs. transient, for example). She is able to identify new business opportunities and to create demand during slack periods in the business cycle. The ideal general manager knows the hotels in her competitive set as well as she does her own. She knows how to compensate for her hotel's weaknesses, how to leverage her hotel's strengths, and how to exploit the competition's weaknesses. The ideal general manager prepares for new competition by aggressively solidifying existing business and even more aggressively seeking new business. She has an attentive, meaningful relationship with all her major customers and is eager to interact with hotel guests and to exceed their expectations regularly.

Operating Results. The ideal general manager budgets aggressively and continually strives to exceed budgeted performance. He is focused on adding long-term value to the hotel; he does not pursue short-term performance and engage in "window dressing" to the detriment of creating value over the long term. He is constantly striving to find new and creative opportunities to generate incremental revenues and profits in every operating department of the hotel.

The ideal general manager is focused on profits, not just revenues, and never submits a proposal to the asset manager without assessing what it means for the bottom line. He understands the profitability of the hotel both by its component businesses (rooms versus food and beverage, for example) and by source (i.e., which customers are truly profitable). He realizes that a manager cannot compensate for a product sold at a loss per unit by increasing volume. He eagerly utilizes technology to maximize profits generated. He reacts quickly and effectively to economic downturns through aggressive cost management. The ideal general manager understands the owner's financial hurdles and objectives. He recognizes that he and the asset manager are financial partners and embraces the asset manager's financial objectives as his own.

Capital Expenditures. The ideal general manager spends the owner's money parsimoniously, as if it were coming out of her own pocket. She maintains a clean hotel, not only the areas of the hotel the guest sees, but also those parts that the guest does not see. She supports a proactive preventive maintenance program and recognizes the importance of maintaining an effective life-safety system and procedures. The ideal general manager prioritizes capital spending in a manner consistent with the strategic plan. She manages the furniture, fixtures, and equipment reserve with a long-term view and proposes capital expenditures that will provide the greatest value enhancement for the hotel at the lowest cost. She seeks any and all opportunities to extend the useful life of the hotel's capital assets. The ideal general manager is acutely aware of the appropriate positioning of her hotel to maximize results, and avoids making any aesthetic changes to the hotel without the involvement of ownership.

Employees and Community. The ideal general manager maintains superb interpersonal relationships with his employees and strives to minimize staff turnover and associated costs. He has the ability to attract, motivate, and develop a talented and effective executive team. He enjoys a positive rapport with both employees and members of the community. He treats employees fairly, counsels those in need of improvement, and deals decisively with those who fail to improve. The ideal general manager plays an active role in the community, particularly in those areas that will ultimately benefit the value of the hotel. He is, for example, an active board member of the local convention and visitors bureau. The ideal general manager is widely regarded throughout the community as a great corporate citizen.

Communication. The ideal general manager takes charge of the relationship with the hotel's asset manager. She communicates in a proactive, timely, and transparent manner, never withholding important information. She ensures the integrity and accuracy of all financial data provided to the asset manager. The ideal general manager keeps the asset manager informed of all significant issues and avoids surprises. She has the highest ethical standards and recognizes and believes that an effective business relationship begins with outstanding communications.

The preceding overview of the ideal general manager is intended to highlight those skills that a lodging asset manager should seek in the person charged with day-to-day responsibility for the success of the hotel. It is not comprehensive, but it emphasizes the important skills an effective general manager should possess—and therefore the areas where the asset manager must focus his or her efforts in the quest for value enhancement.

Conclusion

It is difficult to predict how the owner-manager relationship will evolve in the future. (See Chapter 5 for a discussion of this topic.) It appears likely that there will be further growth in the number of hotels managed using the owner-operator model, where ownership and management come together under one entity, because owners will continue to seek greater control over the hotels in their portfolios. Hotel managers are likely to continue to focus on improving the profitability of operations while simultaneously achieving great customer satisfaction and preference. Hotel management companies will continue to enhance the usefulness and transparency of information provided to ownership. There will continue to be high demand for talented lodging asset managers who are passionate about practicing their profession and enhancing the value of hotels.

Success in this and any business relies to a great extent on the ability to communicate and collaborate effectively with others. The lodging business, almost by definition, attracts people who enjoy and are motivated by the prospect of dealing with others. The range of skills needed to be a successful lodging asset manager is nearly endless. Today's talented lodging asset manager needs to be a world-class hotelier, a skilled engineer, an energetic salesperson, a brilliant attorney, a shrewd businessperson, a creative interior designer, a proficient project manager, and an ingenious real estate professional. Even with this toolbox of experience and talent, to be truly successful the lodging asset manager must also have the interpersonal skills necessary to create a cooperative, collaborative relationship with hotel management, so that owners and managers work as partners in achieving ownership's goals and objectives. This ability to build effective relationships is the most important attribute an asset manager can possess; those who develop and deploy their ability in this area will move readily down the path to success.