

## Flipping The Hotel Business Model Upside Down

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For many a hotel owner, the food and beverage component of their hotel operation is plagued by low margins and a heavy dependence on occupancy levels, and is offered more as a result of industry custom than any legitimate expectation of contributing to the hotel's bottom line. As a consequence, paying serious attention to, or money on, F&B offerings has not typically been high on the list of priorities for hotel owners. A recent trend, however, challenges the concept that F&B services cannot contribute to hotel profits and may signal a shift in the way hotel owners think about F&B services.



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Hotel owners have started giving F&B providers the “keys” to the proverbial F&B kingdom on the expectation that the F&B provider's brand will make the hotel's F&B department profitable. In some cases, the right F&B brand can even bolster a hotel's average daily rates and occupancy levels. Successfully integrating an F&B provider into a hotel is not devoid of challenges — there are numerous legal, financial and operational issues that must first be carefully considered and analyzed.

Hotel owners have historically relied on a business model anchored by occupancy levels. This business model made large, well-established hotel brands attractive as they offered wide distribution networks, established customer bases and hotel operating experience. The F&B services offered by most of these hotel brands, while requiring a significant capital outlay from the hotel owner and a large portion of hotel real estate to operate, typically generated relatively low revenue levels and little or no return on investment. Additionally, because F&B services were expected by guests, hotel owners were frequently forced to offer them at a loss, using room revenues to subsidize the losses.

Eventually, this reality led to the perception by some hotel owners that large hotel brands lacked creativity and were committed to an outdated business model. Additionally, technology and the Internet were making hotel owners less dependent upon the distribution channels and reservation systems offered by the large hotel brands.

Some hotel owners began carving out a niche for themselves in the boutique hotel space, focusing on bringing a trendy and high-end product to the hospitality market. A new “image-is-key” paradigm was eventually born. Ambiance, buzz and profitability were targeted, and the status quo was no longer acceptable for food and beverage services. But just like most owners would find it very challenging to run their own hotel, they couldn't go at the F&B transformation alone. The right F&B brand was now high on an owner's wish list — combining upscale hotel rooms with a recognized F&B brand made perfect sense.

The outsourcing of F&B services can take one of two forms. In some cases, the hotel owner hires the F&B provider to operate all of the F&B at the hotel but leaves the hotel management to the existing hotel operator. For example, Plan Do See, an international F&B provider with popular restaurants in New York, Japan, and other countries around the world, recently inked an

agreement with the owner of a boutique hotel on Miami Beach to open several high-end restaurants in the hotel and manage the hotel's F&B services. Overall management of the hotel, currently handled by a large hotel management company, will remain unchanged though.

In other cases, in addition to opening restaurants and bars, and running hotel F&B services, the F&B provider gets a piece of the hotel's room operation. A prime example is Nobu which, using its hotel arm, recently struck a deal to add a Nobu Hotel to the iconic Eden Roc Hotel on Miami Beach. As part of this deal for a "hotel within a hotel," Nobu will not only operate an on-site Nobu restaurant and run all F&B services for the hotel, but will also manage the Nobu rooms in the hotel. Nobu's first deal in this format launched less than two years ago at Caesars Palace in Las Vegas.

The theory behind the Nobu model is that the F&B operation generates demand for hotel rooms — a novel concept no doubt. While F&B outsourcing is a relatively new concept, there is a lot to like about either format from an owner's perspective. For starters, F&B services delivered by experienced providers with brand power is likely to increase F&B revenues and profitability. In cases where the F&B brand has a piece of the room business, positive upticks in both average daily room rates and occupancy levels can also be expected. Some would even go as far as saying hotel room metrics benefit regardless of whether the rooms are branded.

There are, of course, challenges inherent in bringing an F&B provider into a hotel. One of the principal challenges is determining what rights the existing hotel operator has with respect to the provision of F&B services at the hotel and, assuming the hotel operator is not prepared to relinquish such rights, reaching an agreement that works for all parties. Other important legal considerations include ensuring the brand cannot open up another restaurant across the street, holding the F&B provider to certain performance obligations and reserving termination rights in the event they are not met, addressing the ownership of intellectual property jointly created for the venture, and how certain important terms, such as total project revenue and operating expenses, are defined in the transaction documents.

From an operating perspective, perhaps the single most difficult undertaking is determining who will be responsible for what after an F&B provider is brought on board. Will the hotel operator continue to control "back of the house" areas of the hotel or will they be shared with the F&B provider? Who will have decision-making authority with respect to which employees? Who will oversee hotel room service?

Because the existing hotel operator and the F&B provider are unrelated, and potentially competing brands, a good dispute resolution mechanism in which hotel industry experts are called upon to resolve operating disputes should also be included in the transaction documents. Bookkeeping and accounting each warrant special attention as everyone needs to be on the same page about who will handle the bookkeeping for which department and, more importantly, the accounting system that will be employed. More often than not, the parties will be required to work together and collaborate if numerical chaos is to be averted.

Finally, the entire budgeting process will need to be clearly outlined so as to avoid the hotel operator and the F&B provider fighting over the same dollars despite the potential for cost

savings and synergies. It should be noted, however, that these three-way relationships are, by definition, complex and a hotel owner should expect a certain level of babysitting when the hotel manager and F&B provider don't see eye to eye.

Something else worth noting is that these sorts of arrangements aren't cheap. A hotel owner would be well-advised to wait until the time is right for the hotel to be renovated before shopping around for an F&B opportunity. The high-end F&B providers don't just put their names on any project, and for good reason — the wrong collaboration can do serious damage to their brand.

In cases where the hotel manager has certain exclusive rights with respect to the hotel's F&B services in its management agreement, hotel ownership will usually need to make concessions in exchange for the hotel manager's approval. These concessions, which can come in the form of an extension to the hotel manager's term or a sharing of the potentially larger F&B pie, will also help to ensure the continued success of the relationship between the owner and hotel manager. The last thing a hotel owner wants before bringing major changes to F&B operations is a souring relationship with its hotel manager.

Overcoming the many challenges inherent in navigating these delicate multiparty transactions can be very rewarding for everyone involved. Partnering with the right F&B provider can lead to greater profits for the F&B department and can increase both average daily rates and occupancy levels. Getting from concept to successful implementation, however, requires the skill and insight of numerous professionals, including legal counsel with experience in the area, to guide ownership through the issues and risks. By flipping the traditional hotel business model upside down, hotel owners can have their cake and eat it too.

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***DISCLOSURE: Tenzer PLLC represented the hotel owners in connection with both the Eden Roc Hotel and Plan Do See transactions discussed in this article.***

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