US Hotels in Cuba: Business Opportunity or Hype?

Commentary by Ari M. Tenzer and Adriana Blanco Maurisset, ***Daily Business Review***

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Ari Tenzer, left, and Adriana Blanco Maurisset, right, of Tenzer.

Just as multiple U.S.-based airlines begin regularly flying tourists in and out of Cuba and relations between the island and the U.S. begin thawing, a new presidential administration and changing of the guard on the island casts doubt on the future of Cuba-U.S. business relations.

It has been nearly two years since the U.S. and Cuba restored diplomatic relations in a historic thaw initiated by Presidents Barack Obama and Raul Castro. And while only Congress can lift the long-festering U.S. trade embargo against the communist government, Obama issued a series of executive orders that eased curbs on commerce by American businesses. Early this year, federal regulators gave approval to eight U.S. airlines to begin scheduled service to Havana.

With the new air service, a surge of new visitors is likely to drive substantial hotel development in Cuba. While several foreign hotel chains have been doing business on the island for many years (think Spain's Melia Hotels), the Cuban government yearns for new partners and more diverse offerings in hopes of boosting tourism revenue on the island. So far, widely reported moves in the hospitality industry include Starwood Hotels signing a deal to renovate and operate three Cuban properties, Marriott's approval to do business in Cuba and Airbnb receiving special approval from the U.S. government to make its listings in Cuba available to travelers worldwide.

U.S. operators entering the market will have to compete, however, against established foreign brands based in countries with a much more favorable view to the island than that of the U.S. government.

But as the Cuba opening tempts U.S. operators, there are several considerations that need to be carefully weighed before moving forward. They should know that success is contingent on diligence, planning and expert-level knowledge of Cuba's byzantine bureaucratic system, while simultaneously adhering to significant existing restrictions on the American side. All of this despite the Cuban government having recently liberalized conditions for U.S. companies to do business on the island offering tax cuts and similar incentives.

American businesses still need licenses from the Office of Foreign Assets Control of the U.S. Department of Treasury and the Bureau of Industry and Security at the Department of Commerce to establish a presence in Cuba. And despite the new air service, pure tourism is not permitted. Instead, travelers must declare why they are traveling to Cuba with stated reasons falling within 12 categories set by OFAC.

Today, doing business in Cuba means doing business with the Cuban government. The fastest-moving lodging projects appear to be those built by GAESA, the military-run conglomerate that owns more than a third of Cuba's 50,000 to 60,000 hotel rooms.

Foreign investors may not purchase land: They must enter into a 99-year lease with the government or manage a hotel likely owned by GAESA. While American owners may develop land and erect structures, they have no assurance that the Cubans won't terminate leases and nationalize projects. There are also corruption risks among government managers who oversee Cuban enterprises. Under the U.S. Foreign Corrupt Practices Act, it is against American law to bribe foreign officials to obtain business. But American executives are almost certainly destined to deal with bureaucrats who are poorly compensated. As Cuba suffers from a lack of transparency, companies may not know the true purpose of certain payments.

In Case of Trouble ...

Companies also face uncertainties if their deals go awry.

One approach to mitigating risk is including international arbitration provisions in agreements that would bring disputes before the International Chamber of Commerce. Its awards are enforceable in states that are parties to the New York Convention of 1958, and Cuba is a signatory. But enforcing an arbitral award against the government of Cuba is no easy feat. Additionally, there are operational challenges abound.

The government plays a large role in the labor market and employers are required to pay terminated employees severance set by the Cuban Ministry of Labor and Social Security.

Cuba's infrastructure is antiquated, with few updates to roads and water and sewer systems since the 1959 revolution. Basic utility services like water and electric are interrupted frequently. Communication is limited since internet access is controlled by the government, and internet connections are still unreliable and censored. The effect that all of this will have on hotel operations and the guest experience remains to be seen.

Furthermore, providing items pivotal to a brand's standards and identity like public areas, f&b offerings, toiletries, and linens, and the like will certainly be challenging to deliver in an economy controlled and restricted by the Cuban government. The flags may need to loosen or change operating standards to operate on the island.

What's next?

Socialism in Cuba certainly will not dissolve into capitalism overnight, even following Castro's death. Less certain is what a new U.S. Congress will do if presented with legislation to lift the embargo, or whether President-elect Donald Trump will close the window opened by Obama's executive orders.

Despite the obstacles faced by U.S. hotel brands looking to grab a piece of the Cuban market, there can be no denying the growth potential in the island's hospitality sector. Only time will tell if the political and regulatory climate both within and outside of Cuba will be conducive to such growth.

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