Controlling irritable budget syndrome

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Owners can take steps to stave off the usual headaches associated with the budget process.

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Editor's note: This is the second column in a two-part series addressing the annual budgeting process. Part one focused on the inherent flaws in the annual budgeting process that are common practice today, and offered suggestions on a how it might be changed to achieve more meaningful output and alignment of interests. Part two offers insight on what owners can do in the existing budget environment.

With enough pushback from owners and asset managers, perhaps the industry will shift to a more rational budgeting process—including the adoption of flexible budgets. In the interim, budget season will, per usual, be a period when a large portion of owners and asset managers are sure to suffer from IBS … Irritable Budget Syndrome. The causes include unsupported revenue projections, sand-bagging, defensiveness, irrational intransigence, etc. The symptoms include anxiety, anger, sleeplessness, disgust, distrust and, in the worst cases, legal disputes.

While most owners are at the mercy of operators' superior industry expertise and information, there are hundreds of things that an owner can do to positively impact financial performance through the budget and business-plan approval process. Here are just a few examples:

1. Start by controlling the temptation to challenge for challenge's sake. Impulsive or unsubstantiated demands will not be well received and will simply result in the operator raising the drawbridge and adopting a fortress mentality. Do your homework and make sure pushback is thoughtful and rational. Unless the owner and operator are on bad terms, thoughtful, reasoned comments will usually be taken seriously (regardless of

whether the specific item is included or excluded from an owner's approval in the management agreement).

2. Engage in early discussions about performance targets prior to budgeting season. Managing expectations can often make the initial budget submission more realistic from the owner's perspective.

3. Prepare, prepare, prepare

- Do your own SWOT analysis and be brutally honest about the strengths and weaknesses of your property and market;
- take time to understand the changes that have recently occurred or are occurring in your market;
- nature abhors a vacuum, and so do competitive markets. Every evaluation metric for your hotel should be measured against a "comparative" set or sets. Look beyond the competitive set specified in your management agreement as it may not provide the most relevant data—especially concerning expenses;
- if you don't have comparative data, buy it from STR, parent company of Hotel News Now, or CBRE. And make sure the hotels you include are as comparable as possible (size, facilities, and amenities, market positioning, union/nonunion, business mix, etc.); and
- consider hiring an expert to level the playing field.

4. Ask your operator to evaluate the vulnerability of your top customer accounts. What are the weaknesses and threats and what can be done to protect **desired business** from new or existing competitors? Just because your sales department has a long and personal relationship with the key decision maker of a particular account does not mean that business is "safe." In today's market, all accounts must be considered as being "in play."

I bolded "desired business" because you may be better off without some accounts—even large ones. Changing business mix or trading out customers is often the fastest way to move the needle on revenue.

Critically evaluate preferred and volume accounts and consider raising rates on those that are underpriced or underperforming, even if they were previously major producers.

The vast majority of management fees are based on gross, not net. Bonuses and performance standards are at least partly based on revenue-per-available-room index scores, which are not necessarily correlated with profitability. Challenge your operator not just on rates charged, but also customer acquisition costs, incremental labor requirements and "freebies" (e.g., breakfast, internet, upgrades, late checkout, etc.).

Challenge sales deployment, goals, incentives, management and measurement. If you do what you've always done, you will get what you always got. Carefully review budget assumptions surrounding group business (commissions, rebates) as these costs are significant. Make sure the operator has considered actual group contract terms for the coming year as opposed to simply relying on historical trends.

Management and ownership objectives are rarely aligned. This is even truer when a brand is involved. Strict adherence to changes in operational and physical brand standards will generally cost you money that is not justifiable in a return on investment sense. You might not always win the battle over inapplicable, unreasonable or ill-timed brand standards, but it is a battle worth waging.

Ensure that all contracts have been rebid annually.

Cost of goods sold for food is an area of extreme vulnerability in most hotels with substantial food-and-beverage volume. The reasons are numerous and include poor menu engineering, unjustifiable chef-driven product specifications, flawed make-or-buy decisions, inadequate controls, lack of bidding, poor vendor selection, inappropriate portion control and/or menu pricing; operator inexperience/indifference; etc., etc., etc. And the worst sin of all … reliance on the wrong benchmarking data (prior performance, prior budgets, comparables that are not really comparable).

Just say NO … or at least challenge the notion that certain items simply are budgeted in the first place, as they set an expectation for undesirable outcomes. For instance, strategies for minimizing staff turnover are better than budgeting for relocation and task force expenses. Fees from group cancellation and attrition are already included in the revenue forecast and, frankly, unless the operator is a psychic, there is no realistic basis for such projections.

As I said, these are merely examples. No list can be comprehensive as every situation has nuances and complexities. The two most important takeaways are: One, do your homework, and two, substantiate your challenges.

The CHMWarnick team has put together some more specific thoughts, in preparation for the 2018 budget season, available by clicking here.

Richard Warnick is managing director and co-chairman of CHMWarnick, the leading provider of hotel asset management and owner advisory services. The company asset manages a client portfolio of over 65 hotels, 28,000 rooms and $15 billion in hospitality real estate. CHMWarnick's owner advisory services cover virtually every aspect of hospitality investment including ground up development and repositioning. The company is currently providing development advisory services for client hotel and resort projects valued at over $3 billion. For more information visit our website at www.CHMWarnick.com and follow us on Twitter @CHMWarnick.