



Why Hotels Should Consider Outsourcing

By [Derek Olsen](#), Senior Vice President, CHMWarnick

Mr. Sean Kreiman co-authored this article and is a Manager at CHMWarnick

As the industry sits at the top of the hotel cycle, one of increasing supply, rising labor costs, peak occupancy, marginal rate growth, and growing customer acquisition costs, hoteliers and asset managers need to evaluate all cost containment opportunities to improve profits and enhance asset values.

As is evident when reviewing the large amount of expense attributable to the Contract Services lines in most hotel P&Ls, many hotels are already outsourcing various components of their operations, including public area cleaning, maintenance, pest control, and landscaping, to name a few. While these functions may be considered routine, there are more profitable (yet riskier) areas of the operation that can be outsourced, particularly those related to labor, which currently accounts for more than 50% of a hotel's total operating expenses.

Outsourcing by Department

Rooms

The most profitable department in most hotels (typically between 70-80% of Revenue), has additional opportunity to enhance margins through the outsourcing of key functions including housekeeping, laundry, and reservations. However, this department also comes with the most challenge given the high-levels of guest interaction. A lack of control in this area of the operation can most adversely impact the entire operation. It is important to consider a hotel's market and positioning when considering making changes to any of these Rooms Department functions.

Food and Beverage

As is evident in the select-service development trend, some investors have elected to eliminate the Food and Beverage function completely. However, if operated efficiently, strong Food and Beverage programming will induce demand, while contributing to the overall profitability of a hotel - just look at the trend of boutique, lifestyle hotels that feature multiple (oftentimes, concurrently operated) operations. While Cost of Goods Sold can be monitored and contained fairly easily through thoughtful menu engineering, labor is a challenge that requires savvy operators. Consequently, outsourcing specific aspects, or the entire operation itself, can be a profitable decision for Owners, who will still benefit from the induced demand that high-performing outlets can have on a hotel's ADR and overall operation.

Other

Many of the functions included in this section of a hotel operation, such as golf, spa, and parking, come with tight margins, and are often considered "guest amenities" with operators resorting to running these departments as cost centers. This should not be the case as shrewd operators can hedge profitability by employing third-party managers for many of these functions. However, integrating the third-party into the operation, maintaining close communication, and continuously challenging these operators are key to achieving revenue and profit targets. It is important to understand that these operators are not always as sophisticated as hoteliers, who need to sell their complete inventory 365 days per year. Third-party



operators should be met with quarterly (at a minimum) and asked to attend portions of annual budget meetings, and submit their plans for the following year. It is imperative that all assumptions be tested for reasonableness when relying on their figures for the overall budget.

Undistributed

In what will likely come with the least amount of risk as it relates to guest interaction, outsourcing back-of-house functions including Accounting, Human Resources, and IT should be evaluated for both economy-of-scale efficiencies, as well as benefits gained through employing experts in each of these fields. However, when outsourcing Security, special attention needs to be placed on this department. While outsourcing Housekeeping in the Rooms Department could be one of the riskiest areas to outsource from a brand or management company perspective, outsourcing Security can provide the most risk to the Owner from a liability perspective. Therefore, it is imperative that this function be thoroughly vetted, and that the Hotel Operator be completely comfortable with the security company being brought into the fold as this function will continue to receive increased scrutiny given the recent tragic events in Las Vegas and other cities around the globe.

Outsourcing Risks

While enhanced profitability and improved performance are attractive factors to consider when looking at outsourcing, it is also important to understand the substantial risk associated with outsourcing, which, to name a few, include:

- Lack of Control - Outsourcing can adversely impact guest satisfaction and the adherence to brand standards.
- Indemnification and Liability - Agreements should be heavily scrutinized to protect the operator and owner from exposure under 3rd party operations.
- Termination - Contracts with arduous termination language can affect Owner's interests at time-of-sale, with encumbered assets typically less desirable to potential buyers.
- Loyalty - The hallmark of any strong property is its employees. Outsourcing critical functions can jeopardize the relationship associates have with their guests, as well as the pride they have in their hotel.

Process of Outsourcing

1. **Is There a Need?** - As we are at a critical time in the cycle where all avenues to profitability need to be explored, evaluating 2017 Forecasted Year End performance not only to 2017 Budget and 2016 performance, but also to benchmarked to comparable properties is particularly important. In addition to reviewing cost metrics it is also important to assess future revenue risk, and the corresponding effects on profit. Outsourcing revenue-producing operations, such as spa or retail, can provide an opportunity to limit potential downturn risk to the Hotel Operator and Ownership by receiving a steady income stream from a third-party operator. It also allows the Hotel Operator to focus their efforts on their strength - selling rooms and food and beverage! This arrangement would be beneficial for the lessee as well as they would then receive all the upside created because of their performance. Limiting downturn risk to Ownership in a recessionary environment can be just as important as short-term growth. This is especially true in departments with low margins, where time spent overseeing operations should be viewed as low-yielding when considering opportunity cost.

2. **Is There a Need?** - As we are at a critical time in the cycle where all avenues to profitability need to be explored, evaluating 2017 Forecasted Year End performance not only to 2017 Budget and 2016 performance, but also to benchmarked to comparable properties is particularly important. In addition to reviewing cost metrics it is also important to assess future revenue risk, and the corresponding effects on profit. Outsourcing revenue-producing operations, such as spa or retail, can provide an opportunity to limit potential downturn risk to the Hotel Operator and Ownership by receiving a steady income stream from a third-party operator. It also allows the Hotel Operator to focus their efforts on their strength - selling rooms and food and beverage! This arrangement would be beneficial for the lessee as well as they would then receive all the upside created because of their performance. Limiting downturn risk to Ownership in a recessionary environment can be just as important as short-term growth. This is especially true in departments with low margins, where time spent overseeing operations should be viewed as low-yielding when considering opportunity cost.
3. **Find a Third-Party** - Bringing in a third-party operator is a risk to the current operation, and should be treated as such. Therefore, it is critical to compare multiple firms when making this decision. When crafting the RFP Document, it is essential that the document be presented in a fashion that is respectful of the respondent's time, but also provides framework to ensure that the responses address your team's biggest concerns. Superfluous questions should be replaced with poignant, measurable questions that address an operator's assumptions - the goal is to ensure that an educated decision can be made based upon the information provided. Depending on the size of the project, a round of interviews should then be conducted. Be sure that the candidates have been provided your questions far in advance so that a decision can be made expeditiously.
4. **How to Get Management Team Onboard** - It is imperative to ensure that all tools are being used when making a decision as critical as this, and an Asset Manager's strongest tool is their Hotel Management Team. The Management Team should be included from the beginning of the process and help craft the RFP to ensure that all operational risks are accounted for. This is also the time when improvements to operations can be evaluated, so it is crucial that the Executive Team helps lead this process and provides a strong presence in the interview process. It is key that the Management Team is fully supportive of the decision to outsource, the performance goals that are set, and the vendor that is hired to achieve them.
5. **What is Plan B?** - Given the tremendous risk associated with transitioning an operation from the Hotel's control to an outside vendor, there needs to be an "out" if performance does not materialize as expected. This should be well established ahead of the contract signing and it should be made clear in the original RFP document what the Owner's expectations are in relation to termination for non-performance. Ownership should structure this clause so that there is no fee associated with termination when caused by the Operator's failure to meet specific performance thresholds; however, depending on the function that is being outsourced, an Owner might want to provide the opportunity for the vendor to "pay-up", or cure, any shortfall in profit to avoid termination with shortfall resolutions more likely to be acceptable in purely "profit" departments such as AV and Parking.

Lessons Learned and Areas Requiring Extra Scrutiny

- Some departments are easier to outsource than others, and come with less risk due to limited guest interaction.

- While additional costs related to oversight are not always evident, consideration of time spent overseeing a third-party should be evaluated when making the decision to outsource functions of the operation.
- Hotels operating in markets with organized labor need to have a clear understanding of the impact outsourcing might have on existing union contracts, and the Hotel's susceptibility to future organization attempts.

Outside the Box

In addition to expense savings, there are plenty of revenue-enhancing, outsourcing opportunities to be had as well. Revenue Management is a perfect example of a field with a deep bench of talented firms who can provide opportunities for increased profitability. Independent hotels, and smaller management companies might benefit the most from the sophistication these firms can provide to their operation. Ecommerce, Marketing and Reputation Management are all areas that could potentially be improved by engaging professionals that specialize in these fields.

Moving Forward

Outsourcing components of hotel operations is very much location-driven, property-specific and varies based on Ownership's investment objectives. So, while outsourcing might not be the solution for every hotel, at this point in the cycle, an astute asset manager or operator should evaluate all opportunities to enhance profitability. When pursuing the employment of a third-party, performance should be closely monitored, with transparent lines of communication between owner and operator to maximize guest satisfaction.



*Sean Kreiman is a Manager at CHMWarnick, the leading hotel asset management and owner advisory services firm. As part of CHMWarnick's asset management team, Mr. Kreiman is actively engaged with several properties under the company's asset managed portfolio, with a specialization in lifestyle and luxury-positioned hotels. He is responsible for identifying opportunities for enhancing hotel operating performance and asset value and is currently overseeing significant capital projects, including the repositioning of food and beverage operations at major urban lifestyle hotels. Kreiman's past experience includes hotel development and acquisitions, business development and hotel and restaurant operations. Mr. Kreiman can be contacted at skreiman@chmwarnick.com *

Derek Olsen, is a Senior Vice President of CHMWarnick, the leading hotel asset management and owner advisory services firm. Olsen brings more than 20 years' hospitality advisory and asset management experience and a master's degree in real estate to CHMWarnick. Mr. Olsen brings expertise in the areas of hotel/portfolio valuation, cash flow analyses, market and industry trends and special projects focused on increasing profitability. He is an integral member of CHMWarnick's asset management and transaction team, and has personally underwritten more than 300 hotel acquisition deals, many representing complex transactions with significant development and reprogramming elements. Mr. Olsen can be contacted at 978-522-7000 or dolsen@chmwarnick.com Please visit <https://www.CHMWarnick.com> for more information. **[Extended Bio...](#)**

HotelExecutive.com retains the copyright to the articles published in the Hotel Business Review. Articles cannot be republished without prior written consent by HotelExecutive.com.