

## The ins and outs of outsourcing hotel F&B

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Partnering with the right F&B provider can lead to an increase in profits for the F&B department and can drive up ADR and occupancy levels.

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The food-and-beverage component of hotel operations historically has been plagued by low margins and a heavy dependence on occupancy levels. Hotel owners usually offer F&B services 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 change in the way hotel owners approach F&B services.

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. The right F&B brand can even bolster a hotel's average daily rates and occupancy levels. However, integrating an F&B provider into a hotel is not an easy task. There are numerous legal, financial and operational issues that must first be carefully considered and analyzed.

### Image is key

Hotel owners historically have relied on a business model anchored by occupancy levels. This business model made the larger, well-established hotel brands attractive, as they offered wide distribution networks, established customer bases and hotel operating experience. While typically generating relatively low revenue levels and little or no return on investment, the F&B services offered by most of these hotel brands require a significant capital contribution from the hotel owner and a large portion of hotel real estate to operate.

Additionally, because F&B services were expected by guests, hotel owners were frequently forced to offer them at a loss and use room revenues to subsidize the losses. This eventually led to the perception by some hotel owners that large hotel brands lacked creativity and were committed to an outdated business model. Also, 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 creating a niche in the boutique hotel space, focusing on bringing a trendy and high-end product to the hotel industry.

A new "image-is-key" paradigm was born. Hotel owners focused on ambiance, buzz and profitability, and the status quo was no longer acceptable for F&B services. But most owners realized they could not transform F&B departments on their own. Owners began searching for the perfect F&B brand for their hotels; combining upscale hotel rooms with a recognized F&B brand made perfect sense.

### Outsourcing F&B

Hotel owners can outsource their F&B services in one of two ways. In some cases, they hire an F&B provider to operate all of the F&B at the hotel while leaving the hotel management to the existing hotel operator. For example, one global F&B provider with popular restaurants around the world, including New York City and Japan, recently signed an agreement with the owner of a boutique hotel on Miami Beach to open several high-end restaurants in the hotel and manage the property's F&B department. However, the overall management of the hotel, handled by a large hotel management company, will remain unchanged.

In other cases, in addition to opening restaurants and bars, and running the hotel's F&B department, the F&B provider can get a piece of the hotel's room operation. A prime example of this second scenario is Nobu, which, using its hotel-arm, recently signed 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 operate an onsite Nobu restaurant, run all F&B services for the hotel and manage the Nobu rooms within the hotel. Nobu's first "hotel within a hotel" deal launched less than two years ago at Caesars Palace in Las Vegas. The theory behind this second model is that the F&B operation can create a 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 are likely to increase the profitability and revenue of the F&B department. In cases where the F&B brand has a piece of the room business, hotel owners also can expect increases in ADR and occupancy levels. Some even believe hotel room metrics benefit regardless of whether the rooms are branded.

### The challenges

There are challenges associated with bringing a third-party F&B provider into a hotel.

One of the major 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 surrender such rights, reaching an agreement that works for everyone involved. Other important legal considerations include: ensuring the brand cannot open up another restaurant across the street; imposing performance standards on the F&B provider and reserving termination rights in the event they are not met; addressing the ownership of

intellectual property jointly created for the venture; and properly defining certain important terms, such as total project revenue and operating expenses, in the transaction documents.

From an operating perspective, perhaps one of the most challenging undertakings is determining who will be responsible for what after an F&B provider is brought on board. Will the hotel operator continue to control the "back-of-the-house" operations of the hotel or will it share the responsibility with the F&B provider? Who will have decision-making authority with respect to which employees? Who will manage the roomservice department?

Because the existing hotel operator and the F&B provider are unrelated and potentially competing brands, a comprehensive dispute resolution mechanism in which hotel industry experts are called upon to resolve disputes also should be addressed in the transaction documents. The bookkeeping and accounting procedures also warrant special attention as all parties need to be on the same page about who will handle the bookkeeping for which department and, more importantly, which accounting system will be employed. Often, the parties will have to work together to prevent numerical chaos. Lastly, the entire budgeting process will need to be clearly outlined to avoid the hotel operator and the F&B provider fighting over the same dollars despite the potential for cost-savings and synergies.

In the end, due to the complexity of these three-way relationships, hotel owners 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. It would be wise for a hotel owner to wait until the time is right for the hotel to be renovated before shopping around for an F&B provider. The high-end F&B providers don't just partner up with any hotel; the wrong collaboration can damage their brand. In cases where the existing hotel manager has specific rights and duties with respect to the hotel's F&B services in its management agreement, hotel ownership usually will need to make concessions in exchange for the hotel manager's consent. These concessions, which can come in the form of an extension to the hotel manager's term or a sharing of the F&B revenues, also will contribute to the continued success of the relationship between the owner and the hotel manager. The last thing a hotel owner wants before bringing in a third-party F&B provider is a souring relationship with its existing hotel manager.

Overcoming the challenges associated with navigating these delicate multi-party transactions can prove to be rewarding for all the parties involved. Partnering with the right F&B provider can lead to an increase in profits for the F&B department and can drive up ADR 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.

Ari Tenzer has extensive experience advising clients on real estate transactions, including acquisitions, dispositions, and the development, financing, leasing and management of real estate. He also has considerable experience in the hospitality industry, representing owners and operators in connection with diverse matters, including negotiating license agreements, hotel and food and beverage management agreements, and restaurant leases.

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