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The Growing Significance of Revenue Management in Hotel Valuation

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Revenue management plays a vital role in the modern hotel technology stack, and demonstrating ROI in a hotel's revenue technology investment goes deeper than year-over-year RevPAR uplift. The additional revenue from the proper implementation of revenue technologies and strategies directly impacts a hotel's bottom line, making it a valuable tool for optimizing the net value of a property.

Forecasted earnings and asset sales proceeds are critical factors in applying revenue science to hotel real estate assessment. It's only a matter of time before the majority of the industry catches up to what leading hotel owners and asset managers have already realized: a smart investment into revenue strategy and technology is the key to driving greater property profitability and value.

Let's buy a hotel! Not something you hear every day, and unfortunately also not something many revenue managers and strategists are exposed to. However, buying and selling hotel real estate is big business. According to research by Jones Lang LaSalle, over the last decade the hotel real estate market saw transactions globally worth over $500 billion. The average size of deals was $47 million in 2018. As I said, this is big business.

I spent several years working in hotel real estate to try and better understand what drives owners and investors to the hotel property market. Why are they buying hotels? Is it the return on investment (ROI)? Is it diversification? Is it the thrill of owning one of the gems of the hotel industry?

Certainly buying The Ritz for $1 Billion is not a decision to be taken lightly, but I imagine driving up to this icon of all icons and taking a selfie out front with the caption "Yeah, I own this" does have some Instagram value. After all, $1 billion is a steal if you consider that the Waldorf Astoria in New York sold for almost twice as much.

I do enjoy Instagram, but in the end, my revenue management background betrays me—I am a numbers guy. The overarching motivation to invest in the hotel market must surely be financial. This brings us back to ROI. According to Wikipedia, ROI is "a ratio between net profit (over a period) and cost of investment (resulting from an investment of some resources at a point in time)." Seems quite simple. I buy a hotel and expect to make enough money out of it that the investment is worthwhile versus investing elsewhere.

This basic principle holds up when we look more specifically at how investors make decisions on the valuation of a hotel and how much they are willing to "invest" when they look to buy a property. I found a good overview of this covered by an article from HVS, which states that although you need to take into consideration a number of different factors, the basic valuation of a hotel asset is done through income capitalization. If you read the article, it explains in detail the calculations and formulas involved in income capitalization.

You may or may not be inclined to study the mechanics of this in detail, but there are two important factors that stand out for me as being critical to the valuation of a property:

1. Forecasted Earnings
2. Asset Sale Proceeds

It is the combination of these that ultimately determine the value of a property. The higher the forecasted earnings and asset sale proceeds, the higher the price of a property. Therefore, as an owner of a hotel asset, there is an inherit benefit to maximizing both when your goal is to increase the value of your asset.

So how does revenue management play a role in this? And is there any place for revenue science and technology in the world of asset ownership? Let's take a deeper look at the two factors.

FORECASTED EARNINGS

Sounds like music to my revenue management ears! Revenue managers live and breathe forecasts. It is their lifeblood and the silver thread that runs through a revenue manager's decision-making process. Earnings are basically revenues minus costs (i.e., profits). Revenue management, obviously, tackles the revenues—aiming to optimize revenue through advanced analytics. The traditional role of the revenue team, balancing occupancy and ADR to achieve the highest possible RevPAR, has long been proven to drive hotel profitability.

However, recent developments in revenue management have changed the game dramatically. No longer is revenue management limited to just revenues. Revenue management is increasingly moving toward total profit optimization, and the role of revenue science in this sphere continues to expand. I wrote about this already several years ago, and this trend has only continued to grow stronger since that time.

There are two elements driving profit optimization—one, the expansion of revenue management techniques and approaches beyond rooms and two, the availability of data and analytics that allow more granular and better-informed decisions that go beyond just revenues.

The combination of these is very powerful. Revenue technology providers are already venturing beyond the traditional rooms optimization applications into other areas of the hotel. Optimizing function space has already been addressed through technology for several years. Other areas are not far behind.

In an article by Cindy Heo from the prestigious Ecole Hotelier de Lausanne Switzerland, it becomes clear that there is an ever-evolving move toward the strategic application of revenue management techniques to all areas of hospitality. The convergence of revenue, sales, marketing and distribution based on data science will drive greater profit performance for hotels. Better profit also means better forecasted earnings.

Therefore, we can close the loop and conclude that the performance of the revenue management function has a direct impact on the forecasted earnings of a hotel. If you are an owner or investor in hotels, the capabilities of the revenue management function must therefore be one of the priorities when looking to increase the value of a property.

ASSET SALE PROCEEDS

There are a lot of factors that will determine the proceeds one can derive from the sale of a property. However, when we consider the valuation of a property now based on the future value of a property (let's say in 10 years' time), what determines that future value? Obviously, the physical attributes of a hotel contribute greatly to this. "Location, location, location" dates back to classified ads of the 1920s, so this is nothing new. In addition to location, the physical state of the hotel also contributes to the value of a property. There are detailed studies and articles on this (such as this from HVS), but suffice it to say, there is significant investment required in this area.

So what role does revenue management play when determining asset sale proceeds? Well, this brings us back to forecasted earnings. We have established that revenue management plays a key role in driving up forecasted earnings for a property. Forecasted earning in turn lead to a higher property valuation. Therefore, revenue management will also contribute to maximizing the ultimate asset sale proceeds.

LET'S DRIVE THOSE PROFITS!

Okay, now we own a hotel—how do we maximize returns from the asset? We know revenue management plays a critical role in the value creation of the asset, but when should we consider bringing in revenue management to a property? Typical practice historically was to bring in the general manager first, followed closely by sales and marketing and then operations. Revenue management is often brought in long after a property has opened its doors for reservations and optimization of reservations becomes an imperative. But this is now widely considered a practice of days gone by. The earlier revenue management can be involved in the process, the greater the benefit that can be realized from revenue science and concepts.

Consider this, a major hotel chain was recently selected as the operator of a flagship property in London. Although they had experience in other key global locations, this was the first time they were to open a property in London. One of the first actions they took was to bring in revenue advisory services to conduct a detailed market study. After identifying the potential competitive set, the price positioning of the property was done by room type using a sophisticated process incorporating a number of factors including rate-shopping data, reputation scores and other data points.

Using the positioning as a basis, a detailed month-by-month by segment plan was created based on further data points and a scientific approach to data-modelling and forecasting. The outcomes of the initiatives were then used to ensure accurate pricing for contracts, focused sales and marketing efforts, retail price positioning, group quotations and room-type value-adds.

Before any reservations were even taken, the hotel was well positioned to address every possible revenue opportunity available in the market. Carry this through to building daily, weekly and monthly revenue-focused processes and procedures during and after opening of the hotel, and revenue and profit performance of the hotel was established for sustainability and long-term value creation for the asset.

APPLYING REVENUE SCIENCE TO HOTEL REAL ESTATE

The examples outlined are not yet standard in the industry. The benefits of applying revenue science to drive the value of an asset are undeniable. So what is taking the industry so long to make this part of discussions, process and consideration throughout the buying and selling of hotel assets?
A lot has to do with perception—the industry still has a general view of revenue management as the process of opening and closing rate codes. However, forward-thinking hotel businesses have already moved the industry far beyond this.

The Hospitality Sales and Marketing Association International (HSMAI) released its key revenue management publication, and with good reason titled it “Evolving Dynamics: from Revenue Management to Revenue Strategy.” Revenue strategy and revenue science are now viewed as the gold standard in driving property profitability. Those owners and asset managers aware of this are taking steps to ensure this becomes part of property development, property management and ownership discussions. In the end, advanced analytics are already being applied to hotel room prices for a single night. Imagine what they can do for entire hotels over 10 years or more.

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