

# DEVELOPING A SUCCESSFUL HOSPITALITY BUSINESS

Philosophy and Practice

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Nicholas Burton-Howat



“Nick’s book on creating successful hospitality businesses is a very welcome addition to the library. It not only reminds the reader of well-known (but oft-forgotten) common sense, but also provides interesting and invaluable background material, so that this common sense is based on macro- and micro-economic theory and practice. Nick’s work is sure to become essential reading for all.”

**Trevor Ward**, *International Society of Hospitality Consultant,  
Managing Director, W Hospitality Group, Nigeria*

“*Developing a Successful Hospitality Business* is a deeply thoughtful guide for the investor seeking to make a meaningful impact in the complex world of hospitality. Nick’s many years of experience in guiding the successful delivery of hotels around the world and his ability to lead the reader along a path that is both methodical and engaging will become a ‘go to guide’ for anyone serious about succeeding in this sector.”

**Jo Upton**, *Member, Royal Institution of Chartered Surveyors*

“Written in a manner that can and will help so many aspiring hospitality entrepreneurs who have the desire and the ideas, but not the knowledge of how to make them become a reality. Nick is sharing his incredible wealth of experience of both his corporate and personal acquisitions and there is a veritable mine of valuable information for the reader to help avoid the pitfalls that are lying in wait for both new and experienced entrepreneurs.”

**Charles Holmes**, *Fellow, Institute of Hospitality*



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# Developing a Successful Hospitality Business

Whether dreaming of your very own guest house or remodelling a well-established business, success in hotels and hospitality requires a plan, and this book is packed full of practical advice to help you on your journey.

This book offers philosophical perspectives, as well as taking a real-world approach to developing a hospitality business based around the 3P's (Place, Purpose and Profit), utilising experience and expertise gained globally and offering useful practical insights into the successes. It looks at the methods and the psychology of decision making, communications, branding and marketing, as well as providing instruction on building a Profit & Loss account, appraising real estate opportunities, developing your project and asset managing your investment. These multidisciplinary approaches and often complex concepts are decoded into easily digestible segments.

Written by a hotel and hospitality expert with around 30 years of global experience, this book offers hospitality entrepreneurs and practitioners an important guide on getting into and surviving in the hospitality business.

**Nicholas Burton-Howat** is a hotel and hospitality expert with around 30 years of global experience, in three main areas – hospitality operations, hotel real estate and management consulting. This experience along with a Master of Science in Banking and Economics and a Master of Business Administration in International Commerce, ensures a data-driven perspective across all areas. Regularly working in Africa, UK, and USA, Nick has delivered for clients including multinationals, UHNWIs and Sovereign Wealth Funds, as well as raising venture finance to acquire and transform a failing corporate hotel into a boutique success. Nick has also created an innovative co-working hotel concept and established a fund to finance its roll-out across Europe. Finally, he has conducted 150+ feasibility studies and development appraisals for major hotel brands in 45 countries.



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## Philosophy and Practice

Nicholas Burton-Howat

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*To Clare for encouraging me to pursue my genius and reminding me,  
complexity finds us all, so keep life fun and simple!*



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# 1

## Chapter

# P minus 1: Preparation

## Getting Your Head Straight

### Introduction

As a new dawn of artificial intelligence looms, there are those who keenly anticipate its potential benefits and those who fear what it will do to the jobs of trained, skilled creatives and technicians. With justification, some fear the *Terminator*-esque moment military hardware becomes self-aware, causing even pillars of the tech community to call for the brakes to be applied, at least until we can better understand the potential impacts and build in the necessary safeguards. Yet the troll farms and intelligence services of nefarious nations press on regardless, seeing only the opportunity to leapfrog their adversaries and disrupt what is left of the liberal, democratic and civilised world. Whatever happens tomorrow, the truth is, AI is already here today, and it has the power to advance and/or decimate whole industries in equal measure. At the same time, and by most accounts there is a pandemic of isolation, which is only likely to increase as more is done remotely or by machines working autonomously. A lack of interpersonal human contact creates loneliness that has recently been identified as the single greatest factor influencing longevity of life, worse than smoking or obesity. For the sake of saying it and in case you were wondering if this book was part of some elaborate AI smokescreen, I can assure you I am a human, who is entirely less intelligent than a machine, but who has over 35 years of experience in the hospitality industry.

Despite what might appear to be a gloomy outlook, I am very positive about the future and believe it is bright for humankind. My trust is founded, at least in part

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on the ingenuity and hard work of budding hospitality entrepreneurs, like you. What gives me these grounds for optimism are twofold. Firstly, I firmly believe in Joseph Schumpeter's *Gales of Creative Destruction* – the principle that good can come from the seemingly bad, indeed the destruction and replacement of old practices is a necessary and vital consequence of innovation. Oft-quoted examples include the introduction of the production line to manufacturing by Henry Ford, or the rise and fall of the US rail industry. Having largely replaced stage coaches for long-distance travel, rail became the preferred mode of transport for transcontinental journeys. The industry saw no challenge to its dominant position, until the introduction of commercial airflights, which pretty much wiped it out overnight (aside from the transportation of bulky materials). A more contemporary tale might be the near total destruction of celluloid film by the arrival of digital cameras and smartphones. Whichever example resonates for you, what's worth remembering is that at its core, *Creative Destruction* is dependent on four factors: innovation, competition, entrepreneurial spirit and capital or investment. Firms and individuals need to be ready to invest in change, and sometimes it can take considerable financial risk when you're radically changing an entire system or practice. The second reason for my optimism, is the nature of humanity and our need for authentic interpersonal relations. When people visit their local bar, they're rarely doing so because they're in a life or death struggle to find food, water and shelter. No, they're there to interact with other humans. These humans gather together and are united by common purpose, and however subtly, loosely or ephemerally, a group establishes. This group forming behaviour is part of our very being. Membership of a group provides safety, support and comfort to individuals, as well as affording the opportunity for information collection and personal comparison. In turn, we gain understanding of ourselves and our place in the world, determining our social identity, our sense of self and importantly, satisfying our need to belong. Most of us instinctively know how important group acceptance is, and feel uncomfortable just at the thought of rejection. Studies have shown that deliberate exclusion (ostracism) is highly stressful, potentially resulting in confusion, depression and aggression. Magnetic resonance imaging of ostracised subjects' brains, suggests increased activity in the areas of the cortex associated with the experience of physical pain.

Members of a group will form bonds and exhibit reaffirming behaviours that further strengthen the set, experiencing improved personal and collective self-esteem when included in the gang. Mavericks and overt non-conformists are quickly pushed out. This tendency explains why groups tend to be led by a single strong *alpha* who shapes the group narrative and direction of travel, and also why having two equally strong alphas in a group usually results in a battle for control - to be top dog. A second alpha who wishes to remain in the group and avoid a confrontation will ultimately need to subordinate themselves to preserve the status quo and maintain harmony. Formal groups develop over time, going through distinct stages, of forming, storming (disagreement and conflict), norming (when

the group finds its purpose and everyone finds their place), performing (when it hits its stride) and adjourning (when the group disbands). In a bar-room context, you may see all the stages of development in a single evening, and see them repeated nightly – often with a few central actors appearing in slightly altered, *new* iterations each time.

Meeting in person, in a physical space, brings an important aspect to belonging, given that around 90% of communication is non-verbal. These additional signals are not things that can be easily replicated online. The video camera, for example, is incapable of accurately relaying nuance, transmitting chemical cues or giving situational context. I'm sure we all recall the remote TV interview when the rogue child wanders into shot and is rapidly ushered out of the room by a nanny, or the Zoom call that revealed the town leader wasn't wearing a full complement of clothes? Being face-to-face truly matters and our modern tools, however brilliant and convenient, sometimes mean our communications fail the human authenticity test. Our need to socialise in person is my second reason for optimism in a technologically dynamic world. AI-powered automation may solve many labour issues for hospitality operators, but it will still be some time before a robot can come close to replicating the natural welcome of a sincere food server or bartender, and it will never replace a chat with another human over a cold drink. Equally, it is unlikely that a machine will replace a switched on hospitality professional's ability to anticipate a guest's evolving needs based on their shifting demeanour...at least not for a while. Will a robotic interaction ever *make* that holiday of a lifetime?

Back down to Earth, and before you question whether I've been at the Kool-Aid, the hospitality sector undoubtedly has had and will continue to have tough times. It has recently had to endure *black swan* events like the pandemic, with all of its related economic and societal changes, as well as wars, terrorism and, going further back, the global financial crisis and the *great recession*. There is always something going on somewhere in the world that discourages people from travelling or spending. But, as an observer and enthusiast in the business, I'll wager that hospitality is about to enter one of its golden ages and now is a great time to be getting onboard. Without question, the sector will continue to hold on to some of its tried and tested practices, yet innovation will bring offerings still to be imagined. However, as with all creative destruction, the path won't be all plain sailing. By my reckoning, and based on my experience on around 150 different projects, only around 4% of ideas made it all the way through development to business maturity. That's about the same attrition rate as the north Atlantic salmon fry - an idea must survive the rapids of fickle consumer choice, the perils of economic ocean currents, predatory investors and tough competitors.

Whether you've already had a your *eureka* moment and can see a clear path forward, or you're just pushing the idea of being a hospitality entrepreneur around

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your plate, weighing the choice to take a bite or hide it under your knife and fork, know that it's going to be an epic voyage. What's more, it's likely that the plan will evolve, and at the risk of restating vapid wisdom, it will be just as much about the journey as a destination. Either way, it's important to set off with enthusiasm tempered with realism and avoid falling into one of the first traps straight out of the gate, i.e. that a good idea and determination are all we need to be successful. When we recall stories of businesses or entrepreneurs, we are prone to remembering the success stories and the swashbuckling innovators who changed whole industries or even society itself. We latch on to their aphorisms and imagine how we can apply them in our lives; entire websites are dedicated to relaying the truisms of the famous. The problem is that we're unwittingly working with a biased dataset – we remember the success stories because the failures are invisible. The latter go unreported, even though there are many more of them than the successes (in 2022, Forbes estimated around 90% of start-ups fail). Drawing conclusions only from what we can observe is known as *survivorship bias*. If we listen to the *survivor* stories in popular culture, Elon Musk, Steve Jobs, Mark Zuckerberg, Bill Gates, Larry Ellison, and Michael Dell, to name a few, we might think that, aside from passionately pursuing our idea, all we need to be successful, is to *drop out* of college. Yet with over 800 universities worldwide offering entrepreneurship courses to nourish tomorrow's fledgling billionaires, we also need to consider the failure rate and the causes. To think that to *drop out* is essential to our success is to apportion causation to a correlation within a very limited data set.

While he is criticised for his lack of scientific experience by the polymath and father of modern statistics, Sir Ronald Fisher, Abraham Wald is our unsung hero of not falling into survivorship bias, demonstrating how important it is in real world scenarios. In an effort to improve aircraft survival rates, Wald famously reviewed damage done by enemy fire to returning bomber aircraft in WWII. The patterns of bullet holes on these aircraft showed a concentration of hits around the centre of the aircraft, tailplane and wing tips, while the engines, nose and aft fuselage went relatively unscathed. A casual observer might consequently conclude that the areas hit should be better protected against enemy fire. However, Wald astutely determined that the opposite was true. These aircraft were the ones that made it back from their sorties, they were the survivors – despite the impacts in these locations. Contrary to the obvious, Wald's inference was that these hits were survivable (the planes had made it home after all), while hits elsewhere were likely lethal, as evidenced by the lack of...evidence. He concluded therefore that it should be these other areas (engines, fore and aft fuselage) that needed greater protection.

If you think you'd spot survivorship bias at 100 paces, consider the saying *things were made better in the old days, or modern houses are not as well built as old ones*. Both of these statements could be subject to survivorship bias. Badly made things of yesteryear will in all probability break and be thrown away. The poorly constructed

speculative developments of London's 1670s have long since been pulled down and replaced by contemporary structures, leaving only the strongest, better made examples of the era surviving to the present day. The point is that we all have biases, and these biases can inhibit us from seeing the true picture. This is important because accurate analysis is fundamental to developing a clear understanding of any given situation, and good awareness is key to making good judgements and decisions. Don't be put off from having a go, but remember, it is usually easy to get into something, be that a business venture or volunteer work, and often much harder to get out of it when you find it wasn't what you expected or wanted. So, be sure you know what you're getting into first - trust me, there will still be plenty of surprises along the way to keep it interesting once you get going.

Being realistic and by my somewhat empirical evidence, about one in five projects survives from genesis inside someone's head to physical opening of the business. Of these, a further one in five sustainably trade their way to five years in business – that's 20% of 20% of the starters. This book, a collection of thoughts and tips fermented and garnered over years, aims to provide a framework for new hospitality entrepreneurs and answer a few of the questions I wish I'd had the presence of mind or opportunity to ask when I started out. My writing comes from experience and applied logic and consequently there's more personality to the content than you'd find in a straight technical manual. I'm sure there will be certain things that you will disagree with or question, which is great – it means that you're truly engaged. Right, all said and done, let's get started.

## The Personality for Hospitality

So you've now got some ideas as to how you're going to lead, let's consider what a life in hospitality actually means. As Eleanor Roosevelt suggested '*True hospitality consists of giving the best of yourself to your guests*'...and that includes at 11:00pm, when thanks to a frozen pipe, the rapids that just appeared down the main staircase, are creating a new tarn in the lobby, and which very inconsiderately coincided with a heated dispute over the restaurant bill. Believe me, it happens, it has happened...that and worse. Anyone can find dealing with the paying public exhausting at any time, especially so under stress and at the odd times that these events choose to happen. If you're new to the industry and/or introverted, it can be 10x worse. So if you're *that* customer, struggling to make yourself and the importance of your needs understood to the underpaid youngster in front of you, have a thought and have a care. Don't demean them, empower them, appreciate what they're dealing with, work out what your best resolution looks like and present it calmly. And before you say *the customer is always right*, and that *it's not my job to manage the help*, remind yourself that it *is* your job to be a decent person; after all, they're not paid enough to deal with a public adult tantrum. Except for an emergency where people are in danger, I don't care who you are or how bad it has been, always refrain from shouting or cursing, you have no idea the unnecessary

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and lasting damage you can do; don't be a bully. We'll discuss customer service in greater detail later in the book.

All that said, if you are introverted, don't let the very occasional challenging human interaction be a reason not to enter the industry; it has many highly fulfilling elements to it as well, and those outweigh the challenges, even on a bad day. So don't be put off for life, at least have a go, you might just find your schtick and bloom. There are many different and rewarding pathways in hospitality and once you have mastered a few customer service techniques, you might even experience that amazing feeling of turning around a guest with the screaming *abdabs* ('a case of extreme anxiety', as per Collins English Dictionary). Introversion is in no way a barrier to success in hospitality, it's just worth recognising that if you are introverted, you will tend to become tired more quickly when dealing with the public. Equally, just because you're an extrovert Toastmaster or TED talk champion, it doesn't follow that you're going to go down a storm on reception in a guesthouse. It is going to take a lot of hard work whoever you are. Just remember, whichever way you're wired, just don't be *strange* (unusual or unexpected, which makes people feel slightly nervous or afraid). *Strange* is a barrier to success. If you are worried that you might be a bit strange, developing a healthy level of personal awareness is important and you can improve this by focusing on others and asking for feedback. Greater self-awareness will come from being clear about your strengths, weaknesses and the impact you have on situations – try and be aware of the consequences of actions (good or bad).

Despite thinking I know enough about the industry to write this book, I continue to this day to seek out advice from peers, whether that's because of a specific expertise they hold, or just to get a second opinion on a general matter. I only wish I'd started doing this from the beginning, rather than pridefully concealing my weaknesses and insecurities from people who wanted to help (people always like to be asked their opinion and friends always want to help if they can). Because of my stubbornness, I missed out on a great deal of wisdom that could have saved me considerable difficulty over the years if I'd only asked for help. So even if you don't regularly get confused looks when you speak, or have an innate attraction to the solitude of lighthouse keeping...be bold, be brave and ask someone you trust for feedback. Don't be the person who *thinks* they're a people person...

### Confidence, Reflection and the River of Life

My final words on *you* are that you must always maintain your self-respect throughout this undertaking and your life journey. If you don't respect what you're doing and what you've achieved in your life (and what you've learned from your failures too), you will not respect yourself...and if you don't respect yourself, then how do you expect anybody else to respect you? Success and earnings

are very much bound in with this too – you'll never earn what you're worth or achieve your goals without a solid foundation of self-respect. Also, in very practical terms, self-respect will allow you to project confidence. It is my observation that if you exhibit self-confidence to your customers, they will be confident in your offering. If, on the other hand, you appear unsure of what you're doing, their confidence in your offering will diminish and it is at that point they will start picking holes in it and making issues out of small details. Similarly, if you are not self-confident in the manner in which you manage your staff, they will likely start to lose confidence in you and what they're doing, questioning your instructions and their allegiance to the business and you. I'm not saying be arrogant, just confident, which goes back to maintaining your self-respect. It's ok to be humble, just retain control of the narrative, feed people what *you* want them to remember. Own up to your mistakes, for example, just in a way that says, yes, that was an error, I see what happened, I know why it happened and these are the measures I've established to make sure it doesn't happen again. Similarly, carefully invited, received and channelled feedback can help you stay in charge of a situation where things have gone sideways, and remember don't ignore or hide an error – you'll almost certainly get found out and if it gets out in that way, you've lost control of the narrative and you'll look like a fool.

If you struggle with self-respect and self-confidence, why not take 30 minutes or so to draw your *river of life*. The river of life exercise is a very handy way to put your life into some kind of context (whatever age you are), but before you start, I offer you the English translation of the words of Spanish poet Antonio Machado (1875–1939), a leader of the *Generation of '98* (and who had the Line 7 station of the Madrid Metro named after him):

Wayfarer, only your footprints  
are the path, and nothing more;  
wayfarer, there is no path,  
you make the path as you walk.  
  
As you walk you make the path,  
and as you turn to glance behind  
you see the trail that you never  
shall return to tread again.  
  
Wayfarer, there is no path,  
only wake trails on the sea.

(*Proverbios y cantares*, Campos de Castilla, 1917 edition)

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The *River of Life* was originally devised for use in a group context to quickly build trust between strangers, with each individual presenting their *own version* as an introduction to who they are, and is also an excellent exercise in self-reflection. It is composed of five simple, yet deeply engaging steps:

- 1) **Reflect** – imagine your life as a river, with its periods of relaxation or laziness, or when it seemed to flow with great intensity and purpose. When it met boulders and rocks that you had to find a way around, changing your direction, or waterfalls, when things literally seemed in freefall. Give yourself time to think slowly and gradually through this before you commit anything to paper.
- 2) **Map** – once you've spent time on step 1, find a large sheet of paper (I recommend A3 for all creative exercises that don't require a printer) and a pencil (again I find pencils control the speed of your hand movements better), and start to map your river, from your earliest memories through to today. Think about the boulders that changed your direction. The channels where you flowed fast. Don't worry about making mistakes or being too literal at this stage, we're going to add layers on to the river map, so it is more important that it fills the page across the timeline.
- 3) **Layer with the Passengers & River Pilots** – think about the significant people you've met in your life, when you met them, when you might have lost them and why. What their relationship was with you, how they encouraged or discouraged you. The teams and communities you've been involved with. Layer all of these on top of the map at the corresponding points along the timeline. Add how you felt or the outstanding memory you recall at each point.
- 4) **Contextualise** – overlay what was going on in your community or the world at each point that you've identified on the river map. Were they happy times, anxious times, times of economic hardship? Add your defining values and views at the time (if you can remember them) for each of the events you've put down on the page.
- 5) **Review** – take a moment to study your river of life. See if additional thoughts occur. Look at the flow of your life, what were the significant moments of change, or when things flowed in a straight line, and how you felt about these times, how they and other factors influenced your view of life. Take stock of your direction of travel, from where you started to where you are today. Everything that has been, has added to your character and made you stronger and wiser. Is today a boulder moment? What happens next, the direction you choose, is up to you to decide, with all of the power of your life's river backing you up.

You should feel stronger, grounded and more balanced once you've completed this practice, ready for what's to come. If for any reason you don't, know that you

have done the right thing by shining a light on these demons and that by bringing them out into the open, you can begin to move beyond them. Indeed if you feel unsettled or worse by dredging up long-forgotten memories, proceed carefully and seek assistance from a professional if you need to – getting support is the wise thing to do, and once you've reached out once, you'll wish you'd done it sooner and wonder why you ever felt inhibited before. I will just add that the prevailing wisdom in the world of clinical mindfulness (as postulated by Professor Mark Williams and Dr Danny Penman in *Mindfulness: A practical guide to finding peace in a frantic world*) suggests that our brain has developed and trained to solve problems, as part of our survival instinct. This is why you find an unsolved problem rattles around inside your head in repeating loops that typically like to (re) appear in the middle of the night (I gather it is also why you need to sing a song all the way through to the end in order to banish an annoying earworm). It can also be why people slip into depression from a state of mere unhappiness – their brains try to *solve* the unhappiness and in doing so focus on it and its origins, repeatedly. And unhappiness can be triggered by relatively little. When given the intense reviewal, it can gain greater significance, rather than just being forgotten and left behind. It is for this reason, we all need to manage our outlook on life and maintain perspective; that way we may avoid the triggers in the first place.

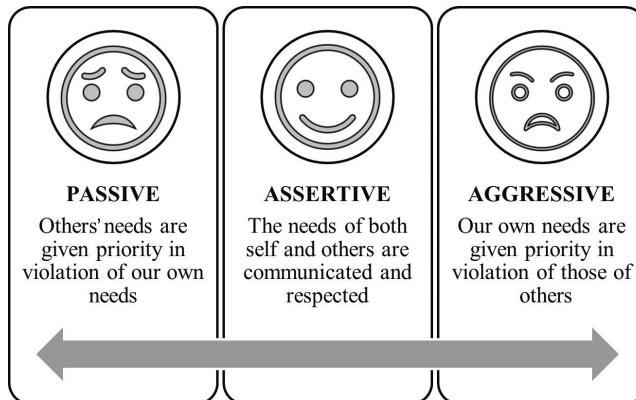
### Assertiveness

Assertiveness is often misunderstood; people think it means being pushy or aggressive, but this is not the case:

*Assertiveness means expressing your point of view in a way that is clear and direct, while still respecting others. Communicating in an assertive manner can help you to minimise conflict, to control anger, to have your needs better met, and to have more positive relationships with friends, family and others...Being assertive is an important communication skill which can reduce your levels of depression and anxiety and improve your self-esteem*

(Centre for Clinical Interventions, 2024)

The CCI handles this subject brilliantly and I recommend visiting their website at <https://www.cci.health.wa.gov.au/>. Not being assertive can have many impacts on our lives and none of them are good. Most significantly, it can lead to debilitating low self-esteem and lack of purpose – both are likely to inhibit progress with your hospitality project. Assertiveness is a learned behaviour and a lack of assertiveness can be due to families telling their children to always put others first. Equally, aggression can be learned from family environments where arguments frequently mean angry interactions, shouting and sometimes violence. You can rate your assertiveness using the tool provided in the assertiveness module #1 on the CCI website – it's a good exercise and I encourage you to have a go and to complete all of the modules. For now I will just quickly give you the highlights on assertiveness.



**Figure 1.1** The Three Styles of Communication: Passive, Assertive & Aggressive

Figure 1.1 illustrates all communication styles, and as we all know, communication can be both verbal and non-verbal.

**Passive** = not expressing what we truly think or feel, or doing so in a self-effacing or apologetic manner. Ironically, it can mean not giving negative feedback when needed, showing a lack of respect for the other person's ability to be in charge of themselves or take bad news. It can be seen in people when they speak and is exhibited in being indirect, hesitant, rambling, using apologies/justifications/qualifiers/self-dismissal or self-putdowns. Body language gives passiveness away with looking down, not making eye contact, hand-wringing, winking/laughing when expressing anger, covering the mouth with hands, crossing arms and so on. Individuals may feel they don't count or will worry people will think badly of them, while consoling themselves in the knowledge they're selfless or rarely blamed if things go wrong (usually because they haven't shown initiative). It can lead to a build-up of anger that can explode at a later date, or more simply result in people staying in bad relationships.

**Aggressive** = standing up for yourself in an inappropriate way, like putting others down to make ourselves look better or attacking when threatened. This can manifest in the use of a strident or condescending voice, often speaking fast with an emphasis on blame words, boasting, threats, racist or sexist remarks. Non-verbally, it can be exhibited in pointing, fist clenching, striding, staring, scowling, crossing arms, sneering, leaning forwards and invading others' space. People like this may feel 'I'll get you before you get me' or 'I'm out to win'. The comfort comes from possibly feeling powerful, in control, getting others to do things for them, but the result is, they build resentment and enemies all around them (which can make them paranoid, or filled with guilt and shame). Again in

a twist of irony, the aggressive person may be covering feelings of inferiority and their behaviour results in their losing self-confidence.

**Assertive** = communicating our beliefs, thoughts and feelings in an open and honest manner without upsetting or putting others down. This will likely be expressed in fluent speech delivered in a firm but relaxed voice, with language that exhibits cooperative phrasing, constructive self-criticism, seeking others opinions and differentiation between fact and opinion. Nonverbally, the individual will maintain healthy, direct eye contact (without staring), smile when they're pleased and frown when they're angry, adopt an open posture and receptive listening practices. They won't allow others to take advantage of them and nor will they attack others for being themselves. The result is that they're less worried about protecting themselves and so are less preoccupied with themselves and are better company. They will also tend to maintain higher self-esteem and get what they want from life more often. The cost of moving to a more assertive position (if you're not already there) is that some people who have previously benefitted from your passive or aggressive behaviour, may try to sabotage your new ways. Letting go of old ways can be frightening and sometimes it can be uncomfortable at first when learning to be assertive.

There are several techniques to becoming more assertive, starting with identifying any unhelpful beliefs and keeping a thought diary of unassertive thoughts (identifying the situations, your emotions and your behaviours at these moments). Some people prefer to try behavioural experiments on themselves, when they actually test their prediction that the other person will be upset and the relationship will be ruined when they exhibit assertiveness. While this will likely be a challenge and can be quite anxiety provoking, it will provide you with evidence rather than mere thoughts or interpretations. If you are trying to improve your assertiveness, please read all the modules (especially #6 for techniques that may help).

Starting with Basic Assertion: we can use a statement that clearly expresses our opinions or needs – this is typically an 'I' statement, such as *I must go at 12*. These statements should be specific, clear and concise with no fluff. Additionally, you can use Self-Disclosure to reduce your anxiety, *I feel nervous*, or you might use basic assertion to give compliments or information, such as *I never thought of that, I'd like time to think about what you've said*, or *It will cost £1,000*. Secondly, you can try Empathetic Assertion, when we try and understand the other person's feelings or opinions, particularly if they might conflict with your own needs or wants – *I know you're busy right now, John, but I'd like to make a request of you*, or *I know you don't like the new procedure, however, until it's changed I'd like you to keep working on it*. Then comes Consequence Assertion: when we use a consequence if the other person doesn't do something that is required of them – this is the strongest form of assertion and could be seen as aggressive if not handled correctly or delivered

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with very neutral non-verbal cues. An example might be, *If this happens again, I'm left with no alternative but to apply formal disciplinary procedure, I'd prefer not to.* In the same vein is Discrepancy Assertion: when a discrepancy in what was agreed to occurs. First we must establish whether this was a misunderstanding or a contradiction, when someone's behaviour doesn't match their words.

There are a number of other techniques that can be used and I encourage you to find them for yourself if assertiveness is something you struggle with. Some people may find Cognitive Behavioural Therapy (CBT) helpful to help them move forward with developing their assertiveness.

### Questions of Self-Discovery

So, with all that said and before we go any further, I think it is important to take a deep breath and answer the self-discovery questions – the really tough questions:

- Why are you doing this? Do you feel passionate about an idea, or are you simply frustrated by your current situation and inability to change your future?
- What do you hope to achieve? Do you want to be wealthier, or be in charge of your own lifestyle/hours/destiny, or do you want to do something for the local community?
- Is there a better/simpler way to achieve it? Hospitality is literally one of the hardest industries to succeed in, with the average failure rate being 10% higher than the rest of the economy...are you sure there isn't an easier way to achieve what you want?
- What is your risk tolerance and what's your back-up plan? Can you survive if it fails? What are you going to do if it does? How much would your pension advisor say you can or should invest in a high-risk venture rather than a more stable investment? What pressure can your family stand by your pursuit of this dream?
- What resources do you have at your disposal? Look at your outgoings and household income, can you afford to go without income for a period of time? Do you have people you can call on for help?
- How good are you as a manager and negotiator? What skills do you need to enhance or develop to make this a success? Lots of people take the power of their employer for granted when it comes to doing business with other firms or funders – can you do it without that an umbrella? Do you have all the skills to do this? Where do you think you need help or training?
- What is your timeframe for this and what is your exit? How long are you going to give this? How do you plan to leave the business – who is going to buy it or are you leaving it to the kids...and will they want it?

## Finding Personal Discipline

Buying or developing any business is typically a long-term commitment that requires focus, dedication and a certain amount of good fortune. Now let's be clear, the dedication has to come from you and I can't make you lucky, you'll need to discuss that with your stars, the fairies, or a friendly shaman. While there are no guarantees of success and not everything always worked out in my own dealings, I can help you with the focus...on the things that will help you to be successful. That starts with conquering any lingering or latent procrastination habits. Our brains see most tasks in our daily lives as work. *Work* requires effort and our brains prefer easy street, they're not keen on exerting themselves unless absolutely forced, particularly if they can find something else to do or if there's an easier option. When we are first given or initiate a project, it normally comes with a completion date, and while we might say 'oh great! another deadline!' it is actually useful, it's a point in time that focuses our minds. Once we know when something has to be done, the next step is usually to plan how we'll do it and what resources we'll need, including time. We plan our work and allocate time to it, in broadly even blocks, more or less evenly spaced in the time available before zero hour. That way, we can get the job done methodically, on time and avoiding stress. Following this path, many of us will get as far as putting things down on paper, and even completing the first few sections. Then something crops up and gets in the way, often small things that just require a couple of minutes' attention – a delivery at the door, a calendar chore reminder or a social notification. The problem is that a couple of minutes quickly becomes most of the time we allocated to the task.

In reality and despite planning, many of us will end up leaving the majority of our task to the last minute, when sheer panic forces us into action. If this isn't familiar to you, and you don't put things off or get distracted, you have rock-solid discipline and share the focus of Shackleton – hoorah! anyone for a brisk 830-mile open-boat navigation of the Weddell Sea? In this case, this means there is nothing much to add on the focus or endurance fronts and this book will have to merely provide a manual filled with technical details of how to develop the business. Alternatively, if you are a mere mortal like the rest of us, you can comfort yourself by knowing you're not alone – humans have a natural tendency towards procrastination. It is important to recognise it so it doesn't ambush you, and then you can outflank it. Blissful ignorance is not so blissful in the long run. The trouble is that, as you set about beginning the task, you can bet your bottom dollar the genie of instant gratification will appear, wafting tempting delights under your nose. They're the attention grabbing, non-work things that your brain enjoys, finds easy to do and that expand to fit the available time – known as *Parkinson's Law*. You'll recognise them, they take the form of browsing internet news feeds, checking your socials and watching *informative* reels – look at the success of a certain short-form video platform where content is '*nine to 15 seconds for maximum impact...to meet...average watch time*' (Shopify, 2023). You may also notice that

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our brains anticipate our feelings of guilt and will dress up these non-productive activities as self-improvement or learning. Let's face it, long-form anything requires commitment and *work*, it's why we listen to podcasts while on a journey or when doing something else.

The important takeaway is that if you are to be successful, you need to build your focus, layer upon layer. Trying to conquer it in one leap will be hard *work* and probably end up putting you off – like overdoing it at the gym in your first week and never going back. Instead, in the first instance just try to recognise when your brain is erring towards *easy* and pull yourself back on course (just a couple of minutes at a time initially). Alternatively, if you find it really, really difficult to drag yourself away from your browser, first identify an untaxing entry point or slipway into the task you *should* be doing, then set the clock and give yourself no more than five minutes of *easy*, before you return to the slipway and get stuck in. Generally, I try breaking it down, and giving myself a series of smaller, realistic, self-imposed mini-deadlines along the path towards the end goal. Build a routine and be alert to the genie. If you sense something bright and shiny creeping into your field of view that lies outside your mission objectives, immediately start doing something, anything related to your true goal, even if it the easiest bit of it (just make sure that you plan and come back to the more *difficult* things on the agenda later). You've got this!

### Bad Decisions

Included in my polemic on hope (coming up) is not dealing with a bad decision or *hoping* that it will come good in time. Decisions are like fruit – they either stay fresh and good until they're consumed (when a new decision is needed), or they were no good when you chose them and proceed to rot. Fruit that is bad has no ability to return to a pleasant ripe state, it will just get worse and continue to decay. The answer is simply to throw it out on the compost, where it'll break down and show you where its badness began – you'll at least gain the knowledge of why the decision was wrong, possibly enough to avoid making the same mistake again. This applies to the toughest decisions of all – the ones to terminate a project that won't come good in the time needed or that will get worse...and these are often the life-saving ones, you kill one thing to salvage something else. So give yourself a break, if you've made a bad decision, undo it, learn from it and have another go. I have seen owners lose everything rather than walking away with something, because they wouldn't make the tough call before it was too late. Instead, they played the *hope* lottery and with '*The odds of winning a Powerball jackpot...near 1 in 292.2 million*' (Associated Press, 2023) that never goes well and is as close to impossible as you can get. Before you say it - *someone's got to win it*, '*the odds of being struck by lightning...are less than one in a million*', let's *hope* that doesn't happen!

## Happiness and Judging

One of the other philosophical foundations bestowed upon me, which I try and live by, is to remind myself that life is tough...for everyone...and *nobody gets out alive anyway!* Life is the supreme leveller and everybody will be impacted by deleterious events at some point – no matter how successful, no matter the circumstances they were born into or how obvious their triumph or misfortune to the outside world – cut people some slack (you don't necessarily know what they're wrestling with at any given moment; we'll look at this later when we explore fundamental attribution). I won't quote it here, but *If* by Rudyard Kipling is strong on this. The iceberg principle refers to only seeing what lies on the surface, and it is useful to remember there is always much that is unseen or unknown to the viewer on the outside.

As human beings we are born with a sense of fairness, and this is consolidated as we are socialised into functioning members of society. Trials have been developed to test fairness, where a proposer offers the receiver a share of an imaginary bounty in different proportions increasingly in the proposer's favour (e.g. 50–50 split moves to 90–10 split). The receiver then has the choice whether to accept the offer on the terms proposed or reject it (meaning neither party receives any bounty at all). In the cases where the balance tips squarely in favour of the proposer, receivers will tend to reject the proposal, even though they also lose out. We are happier to reject an *unfair* offer and punish the proposer for their indiscretion, rather than accept a smaller share of something that has to be better than a fairer share of nothing. The evolutionary explanation is that the system of fairness has developed to prevent *free-rider* situations, where someone benefits from the efforts of the group without contributing to it – and we all learn this system and accept it unconsciously. However, there are unwritten rules governing the fairness principle – it can only be executed between people who have first-hand knowledge of the situation to which it is applied. Fairness at national level is and always will be destined to fail simply because of asymmetry of information (before your instinctive disagreement prompts you to rummage around for an exception to prove me wrong, I would ask you to objectively observe the degree of homogeneity of the fairness achieved in your chosen citation). The problem is that, however well-intentioned or well-meaning, the actors that attempt state-sponsored fairness don't have enough of the information to hand that they need to determine nationwide fairness on an individual basis...which is crucial if it is indeed to be fair across the board. They are too far away from the problem to have enough insight to make fair judgement. It is a question of distance, distance from the issue to be addressed, distance from the individual and influence – can we or should we seek to influence beyond our circle of understanding? To loosely quote Nassim Nicolas Taleb, 'I am, at the Federal level, libertarian; at the state level, Republican; at the local level, Democrat; at the family and friends level, a socialist and with my dog, I'm a Marxist'.

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So the government official tasked with redressing fairness imbalance, has to shortcut, they have to generalise and do something that we will learn later on is one of the cardinal sins of social psychology and branding, to stereotype. Stereotyping is what we are all told to avoid in our diversity and inclusion lectures. Stereotyping means grouping people into categories based on superficial snap judgements, and not actually seeing the individual in front of you at all. You can imagine the well-deserved furore that would ensue, were government to write policy for people grouped together based on the colour of their skin. Similarly, the government can never know any of us well enough to group us on anything other than income, which is pretty myopic. Can you tell how much prejudice or strife someone has had to endure and overcome by looking at their income? The millionaire could have spent their entire childhood in care before successfully setting up and running their own company. My experience is that people don't actually want hand-outs, they'd prefer the opportunity to help themselves, it's certainly more fulfilling (it sits alongside the *you can't have a weekend unless you've had a week*). People just need their *break*, the wisdom to see it and the desire to grab it when it happens.

The next issue is that at this level, fairness becomes a zero sum game – someone has to have fairness taken from them in order to make things fair for someone else who has less fairness. This is an entirely arbitrary judgement based on incomplete information. In other words, however noble the aspiration to elevate all people to the upper end of the scale, the fairness police feel obliged to rebalance fairness. They reduce fairness for some (whether originally gained by overcoming challenges or not), and hand it out to those they decide are in a small bracket of people lacking in fairness regardless of the circumstances. The result is that incentive to strive, to overcome or improve is reduced and instead small brackets of people become small majorities of people who are forced to look needy so they can benefit from any fairness hand-outs going and more importantly, reduce what they are otherwise likely to have taken from them in the rebalancing game. The result is that instead of everyone being elevated to a higher level, everyone is brought down to the lowest level – figuratively, society moves only as fast as its slowest members.

What is more, social psychology demonstrates that *fairness* judged and dispensed by any human will always be subject to biases and petty jealousies. Our judgements of each other will always therefore be based on a skewed perspective and inadequate information, with the potential that they will ironically become unfair and pernicious. How much would any one of us wish our entire existence, over a lifetime (much of which may not even have been lived yet), to be weighed by a stranger, whose only gauge of our life experience, sorrow, happinesses and losses, is how much you earn in any one year? I have seen *Life* taking care of the imbalances, I'm sure you have too. So, for the sake of fairness in your interactions in the world, I urge you to not judge others, or make assumptions about

them – apart from anything it narrows your outlook and you risk missing opportunities (after all, if you assume, you'll make an *ass* out of you and *me*). Before we move on, I'll also just flag that history shows that any state-sponsored quest for fairness, in addition to upending meritocracy, rapidly destroys social mobility as a topsy-turvy unintended consequence. People can't therefore change their circumstances through their own effort – they instead must rely on the government for help. The onus is therefore on us all to be fair in all of our dealings, so that politicians don't feel the need to level the pitch.

Tied into not assuming and judging, is the importance of not taking things personally (or not making assumptions about what or why someone said something to you). The ill-timed and unreasonable outburst you were in the line of fire on, is very unlikely to be anything to do with you at all, and almost certainly 100% to do with the other person (and what's going on in their life that triggered it at that particular moment). The advantage of not taking things personally, is that you're less likely to get bounced into an adverse reaction. If you don't react, you retain control and in the words of the Pirelli advert 'power is nothing without control'. Not only that, their one-sided aggression will look irrational to bystanders and diminish them, not you. You'll also have retained the moral high-ground and avoided inflaming or escalating the situation further.

The final article in my lore for personal stability, and setting yourself up to succeed, is taking responsibility for your own happiness. No one can ever be responsible for someone else's happiness. Happiness is a choice. It is about taking responsibility for our outlook and our actions. Incidentally, if you failed at this today, don't take yourself too seriously, inject some humour and try to be better tomorrow. In the keenly observed words of filmmaker, writer and raconteur, Peter Ustinov '*It is our responsibilities, not ourselves, that we should take seriously*'. After all, nobody gets out alive anyway, so what will it matter in the end? In a world where we're often more aware of our own sensibilities than being vigilant against offending those of others, I give you the words of clergyman and anti-slavery reformer, Henry Ward Beecher '*A person without a sense of humor is like a wagon without springs. It's jolted by every pebble on the road.*'

## Leadership

Now that we've explored people and communication styles, we should probably consider what kind of boss you're going to be. This leads me on to the next area I'd like you to consider as part of getting your head in the right place to start your upcoming adventure: your management style. As with everything else we've discussed, there are no hard and fast rules to this, only guides, and whatever style you choose, it must be appropriate to the situation and should be adaptable as the situation changes. If you do an internet search for leadership styles, you will get a wide variety of choices from the '*6 most common*' to the '*13 Leadership Styles*

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and Their Characteristics' and every essential number of management styles in between. My recommendation: don't overthink it, it's only a guide after all and you will have to adjust your style subject to the context, reaction and feedback you get anyway. For me, the best list is the shortest, and as with understanding people's communication styles, it's no use if you can't retrieve the wisdom easily when you need it. I've seen the following six leadership approaches work successfully in real life:

1. **Transformational Leadership** – as the name suggests, it's all about transforming a project or changing a situation. It's how you inspire your team to be the best they can be to achieve the end goal in an environment of considerable change. You'll need to be forward-thinking and comfortable with change, as well as being good at getting your team to be comfortable with it too. You'll see individual potential in the team and empower them.
2. **Delegative Leadership** – is most appropriate when you are working with highly competent individuals in the team, who don't need much guidance or motivation. Indeed they're the sort of people who will likely see micro-management as unnecessary meddling and resent it. The only issue with this style is that everyone in the team needs to be highly proficient and autonomous – those who aren't will struggle and there won't be a straightforward mechanism for them to register their difficulties.
3. **Authoritative Leadership** – this is not to be confused with authoritarian leadership that you might find in a dictatorship. Authoritative leaders are visionary mentors. They set the goals and lead from the front as they encourage the team to follow. You will often see these leaders spending time one-to-one with the team members, in two-way dialogue. If this style suits your situation, just be careful not to slip into micromanagement.
4. **Transactional Leadership** – this style is used in a lot of hospitality settings, and often not well. It can be thought of as a day-to-day style, where you're not managing significant change. It is very task-oriented, with clearly sign-posted expectations and rewards for team members. Rewards are mostly financial, such as tronc (a pooled tips/service charge distribution mechanism) or bonuses. It is often accompanied by detailed instructions, procedures, processes and staff handbook that makes frequent reference to standard operating procedures and service level agreements. You will find this style deployed a lot in business franchises and with branded operations. My word of caution is that while it is important for consistent customer experience to follow brand guidelines, it is equally important not to extinguish the humanity of the team members that makes the difference to your customers – we've all seen chain restaurants break a service delivery process down so they can hire less expensive or skilled staff, and at the same time, remove the staff personality that makes a guest experience memorable.

5. **Participative Leadership** – this involves frequent engagement with team members almost on a consultative level, seeking their input in decision-making, identifying problems and coming up with solutions. It is a style that is focused on building trust and became increasingly popular as human resource management moved away from top-down authoritarianism to a more inclusive framework that recognised that if you hire good people you'd do well to listen to them. The hospitality industry, being mostly mature in structure and nature, has been generally slower to adopt this approach.
6. **Servant Leadership** – is a very collaborative style of leadership and could be thought of as being very 'green' if you're talking DiSC (Dominance, Influence, Steadiness and Conscientiousness) personality types. It is all about the needs of the team, their goals, aspirations and helping them to achieve their potential (this is discussed later on in the book). You will often find this approach adopted by companies focused on ethical practices or ethical segments of industries. This style of leadership has been seen to reduce staff turnover and thereby recruitment and legal costs, so should be considered on a purely practical level if nothing else, if suitable in context of your business.

Then there's what described as Situational Leadership. Published originally in 1969, Hersey and Blanchard's leadership model has four styles that are applicable to any situation: **telling** people what to do; **selling** - convincing people to buy in; **participating** involving the team; and **delegating** most decisions to the team. Blanchard went on to expand on this framework to make allowance for the aptitude of individuals in the team with his SLII adaption of the four styles of leadership: **directing** or giving orders, with limited assistance; **coaching**, which is the same but with ample support; **supporting**, which is the opposite of *directing*, with plenty of support, but minimal direction; and **delegating**, which gives precious little of anything. You will see certain themes that are consistent between all of these styles and personally, I'd stick to the way you are naturally and modify your approach as you see fit, just being mindful of your team and the options available to you.

For your reference, and just in case you're burning to know how leadership can be expanded into a full 13 styles, here goes: Autocratic, Bureaucratic, Charismatic, Coach-style, Democratic, Laissez-faire, Servant, Situational, Strategic, Supportive, Transactional, Transformational, Visionary – mostly variations on a theme!

## Entrepreneurship

So, I hope I've given you a flavour of what you can expect on your possible voyage into the hospitality industry. If you're thinking I must be mad to even consider

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becoming an entrepreneur, take heart, you're not alone. Entrepreneurs are not necessarily who you might think, according to Edward Lazear's paper on *Entrepreneurship*, and so while perhaps predictably 47.2% of entrepreneurs are Gen X, what might be more surprising is that 84% have a university degree. It is probably seen as natural that 41% of entrepreneurs list passion and belief in their own ideas as their top motivations, with 72% saying that they're *somewhat* or *very happy* with their business ventures. But what you might not know is that The Small Business Administration in America estimates that 41.5% of all entrepreneurs are women, with female entrepreneurship increasing at around two per cent year on year. According to JP Morgan, in 2021, '*Black women are the fastest growing demographic of entrepreneurs in the U.S., with nearly 2.7 million businesses nationwide*'. Otherwise, as per Edward Lazear, typical entrepreneurs are:

**Undervalued** – ‘...[they]...may not be born but made. When employers underestimate (and undercompensate) a worker's value, the rational decision for that person is to start a business of their own’

**Generalists** – ‘...[they're]...well-rounded. Though venture capitalists often talk about finding a founder that 'spikes' on a certain dimension, those most likely to become entrepreneurs are well-rounded...the self-employed tend to be generalists, not specialists...’ They also tended to have had more professional roles in their careers than other, usually with the same employer.

**Suffer Mental Health Troubles** – ‘...Mental health issues run in the family. According to one study, entrepreneurs are much more likely to face mental health problems – both directly and in their broader family. Sufferers of bipolar disorder, ADHD, and OCD are all more likely to go solo.’

**Survivors** – ‘...survived a difficult childhood. Running a business is not for the faint of heart. It is perhaps not surprising then that childhood adversity may increase entrepreneurship rates. One 2021 paper analyzes this connection by observing a group that suffered extreme hardship: China's Great Famine survivors.’

**Older** – ‘...according to the 2018 paper 'Age and High Growth Entrepreneurship' by Pierre Azoulay et al. Focusing on U.S. startups – rather than all new businesses – the National Bureau of Economic Research study finds the mean age for founding a company to be 41.9 years old.’

**Part of a Community** – ‘...according to Hyejun Kim's 2018 paper...[that reviewed]... data from 403,199 knitters active on Ravelry, known as the 'Facebook of knitters.' Kim found that...joining a local community makes entrepreneurial transitions more common...when a knitter enters one of the more than 3,000 'Stitch N' Bitch' groups in the U.S., they are 13–25% more likely to become entrepreneurs.' Additionally, ‘...those who became entrepreneurs – individuals who made and sold original knitting patterns – tended to have undertaken more knitting projects across a range of product categories. For Kim, this echoed Lazear's finding that 'entrepreneurs tend to be generalists with balanced skill sets.' An intriguing wrinkle to this part of Kim's study is that

*entrepreneurs tended to experiment with fewer techniques, suggesting there is value in some degree of specialization.'*

More unexpectedly, other papers note that entrepreneurs tend towards being creative and innovative, problem solvers, risk-takers, resilient, passionate, driven, team players and tech-savvy. If this doesn't sound like you, but you still think you'd like to have a go, don't worry, none of these traits is an indicator of success for an entrepreneur, it is just that these folks are more likely to become entrepreneurs in the first place – having a well-researched plan and making it work are what makes for success.

The SBA 2022 report identifies that small businesses contribute to the creation of 64% of the new jobs in the US, and the 2023 Guidant Financial Small Business Trends Report lists the top 5 industries chosen by entrepreneurs as being *retail* (18%), *food and restaurants* (12%), *health, beauty, and fitness* (10%), *construction and contracting* (8%), and *residential or commercial services/business services* (7%). As it is not specifically measured in this context, I do not have data, but by my rough estimation is that around 30% of start-ups are likely to be in or have some component of hospitality. Finally, before you get too carried away, bear in mind that the same report highlighted the cost of setting up a business can be high: '*3.7% of small business owners paid less than \$50K to establish...26.2%...[paid]...\$50K-\$175K...14.2% [paid]...\$175K-\$250K...[and]...27.3% of the surveyed small business owners had to pay between \$250K and \$500K to launch their businesses...16.3%...\$500K to \$1M... and 12.3% paid...[more].*' As Melissa Horton at Investopedia (2022) reveals '*The most common reasons small businesses fail include a lack of capital or funding, retaining an inadequate management team, a faulty infrastructure or business model, and unsuccessful marketing initiatives*'. Around a third of startups fail due to a mismatch between product and market demand, while for 19% it's incorrect implementation. According to a U.S. Bank study, 82 percent of business failures are due to poor cash management. There are many moving parts that must all function correctly in sequence, but overall you have to get off to the right start – it is essential to plan.

Now that you've consumed all of the information from this chapter, it's time to go back and answer the questions of self-discovery again – be truthful. If you're in a couple, family or small team, complete the questions individually and then come together and share your answers sensitively – no one is right or wrong and it's better to find out now if there are conflicting views or ambitions. If you're doing this alone, get a trusted friend or partner to review your answers and question you on them.

### The Entrepreneurial Rough and Tumble

On the surface, the delivery of a successful hospitality offer is down to the positive interaction of guests with the *place* and the *purpose*, both acting in combination

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to fulfil the guest need. The reason why I add the *profit* to my definition, is that without a prospective return there is no investment, and every project no matter how small, requires some form of investment – even if that's indirect (*time*, for example, is potential *money* forgone from your other activities). Additionally, while observers of the industry will frequently quote the tenet that hospitality is a people business (indeed payroll is usually the single biggest cost), it is often the cost of capital that will kill an enterprise, particularly in its early days. The cost of borrowings can sometimes get out of kilter and turn a net profit into a net loss in an operationally successful business.

In my experience, although the *place* and the *service* are essential, success or failure is almost invariably determined by the money. You can have a great idea, and execute it with supreme finesse, but if you've got your financing wrong, you will fail...guaranteed. More often than not this is down to misaligned interest, rather than malice. For example, you may want to buy a restaurant (the purpose) in a building (the place), which is risky and requires considerable capital (the profit), so you go to a venture capital firm. This VC invests in high-risk, high-return businesses like yours all the time, so its interests are aligned with yours, right? After all, you both want the business to succeed and make good money, don't you? Well, let's see. You pay your staff well and reward your customers' loyalty, knowing that the commitment of both is key to your long-term success. This is the focus of your life, and your tiny co-share of the total investment, or what is known as your *skin in the game*, is significant to you. Conversely, the VC doesn't run businesses (it makes and supervises investments on behalf of its own backers), it dispassionately invests relatively small sums across multiple ventures in the short-term. Because of the high likelihood of failure for many of the ventures, those that survive, must achieve stratospheric returns to offset those losses, to give a blended high rate of return across the portfolio. Now, add the impact of the time value of money, which erodes investment returns over time (don't panic – we'll cover this later) and you end up with a VC who wants to get out of an investment for the highest possible return in as short a time as possible. The VC therefore couldn't care less about any money the business makes after it has exited and will squeeze as hard as it can to get what it needs before that point.

### Having a Plan and Focus

On a more philosophical note, and despite the apparent contrary wisdom of Ted Lasso and Winston Churchill, I encourage you to avoid passive *hope* in the context of your business venture. That is not to say you shouldn't be optimistic, just don't be passive. I agree that self-belief and dreams (goals) are essential, and that sometimes, waiting or doing *nothing* can be part of a clearly defined, active strategy. This is entirely different to denial or drifting into *hoping* the problem will go away or your dreams will come true by themselves. I have seen people go to their graves, unfulfilled, waiting for some unseen force to solve their troubles

rather than tackling them head on – *hope* without action can kill. Don’t think me harsh, I do understand, when the chips are down and you think you’re out of options, the fear can be paralysing and hope may feel like the only thing left. The best antidote to paralysis is to bring the problem out into the open, shine a light on it, and get to the cold hard facts. Facts will lance the boil of denial and only in them will lie your solution(s). It is no coincidence that ultra violet light has disinfectant properties. So if, when you absolutely least feel like it, you can summon the courage to objectively look an issue, armed with the facts, your brain will go into hyperdrive (its favourite task is solving problems) and work with a capacity you’ve never seen before.

All that said, I know there are some things, like your health that may lie outside your direct control (although you can do certain things to positively influence it), where *hope* has its place, but in your business, in the things you can control, you must, summon your inner Shackleton and stay in command. Under Rule 27 of the Colregs (International Regulations for the Prevention of Collision at Sea), a situation may arise when a vessel loses power or steering (the ability to manoeuvre) and is therefore effectively drifting and a danger to other shipping. This is known as ‘vessel *not under command*’ and the stricken vessel must, during daylight hours, hoist two black balls to warn others of its predicament – it’s where the phrase a *balls up* comes from (which is only one ball better than running aground, which is a *complete balls up*, when three balls must be displayed). So don’t be not under command and avoid a balls up. To use another bit of nautical terminology, you want to be *making way*, not just being *underway* – the difference in wording is subtle, but the difference in meaning is significant. Otherwise, *hoping* things will succeed without power and direction (namely a plan), is akin to absolving yourself of responsibility for your outcomes...or drifting.

## Finding Your Genius & Removing Your Limitations

People will often say to others who are looking for their new direction, *follow your passion*, or *do something that you’re passionate about*. This is wrong. Passion is the excitement you might feel from doing something you really enjoy. The problem is that passion only speaks to personal satisfaction. If you want to do something well, over a long period of time, you need a deeper motivation that goes beyond your personal enjoyment, and that is finding your *purpose*. Purpose indicates a stronger reason for doing something, usually relating to a cause greater than oneself (but that is usually also aligned with our own view of ourselves). Morten Hansen, management professor at Berkeley studied 5,000 managers and staff and found that those who worked with passion without purpose, ranked in the bottom 20% of the subjects in terms of performance. At the same time, those who worked with both were ranked in the top 20%. Purpose alone won’t necessarily get you to the top, but combining it with passion means you have a significantly better chance. According to the Harvard Business Review ‘*Values are your*

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*non-negotiable foundation, passion is about what excites and motivates you, and purpose is your deeper reason for existence. These concepts are deeply interconnected, and aligning them will give you the best chance at having a fulfilling life and career'.*

I found my way to this by a different route. My mentor in this is Gay Hendricks, author of *Your Big Leap Year* (a follow-up to his previous publication, *The Big Leap*). I will start by using the quote Hendricks himself opens with '*The mainspring of genius is curiosity*' (Charles Baudelaire, 1821–1867). The main thrust of *Your Big Leap Year* is encouraging you to find your *Genius*. What is your genius? In life, there are the things that we don't do very well and don't enjoy doing, but probably do all the same (because they have to be done). These are the things of our Incompetence Zone. Then there are the things that we do that we are competent at, but are no better at than others. This is our Competence Zone. Then comes our Excellence Zone – when we're doing the things we're really good at and probably take some enjoyment from doing, too. Finally comes our Genius Zone. Our Genius Zone is where our values, purpose and passion collide in a personal big bang. When we're in our genius zone, we're doing what we love to do, what we're really good at and what has the greatest positive impact on the world around us. Starting out on the journey to your genius is hugely empowering and I recommend it to all – it's a really sound exercise that might just change your life. You can probably attempt to conduct the discovery by yourself, but I found the guidance of the book invaluable.

I chose to read *Your Great Leap Year* because it is delivered over the course of a year with daily leaps for you read and practice, as you gradually work towards finding and living your Genius. In my opinion, a life-changing change should take place gradually if you are going to succeed and fully appreciate the transformation taking place as you change. Hendricks is a master in his delivery of sage advice as he introduces the concept of Upper Limit Problems (ULPs), the self-sabotage we enact that prevents us from achieving success) and how to overcome them, and the power of wonder, affirmation and commitment. My personal biggest ULP: money. Worrying about money used to cause a fight response inside my brain, which not only creates mental paralysis, it also meant I would pick unnecessary arguments with loved ones, which were harmful on all sides. Both outcomes used to result in my inhibiting myself from attaining my genius, so I decided to stop it, and if I can stop my ULPs, you can stop yours, too. The other terrific wisdom I took from Gay and that I'd like to share here, is the importance of being grateful, rather than entitled. I used to think that because I work hard, and have done since I was 15, and that I had gone back to school and picked up another three degrees that I was entitled to recognition and a well-paid job. I have learned now that yes I'm worthy of a lot because of who and how I am, I'm not entitled to it – it frees you up to be grateful for everything in life and immediately the things you believed you were entitled to, no longer have power over you.

## Creative Thinking & the Right Side of the Brain

To cut to the chase, the brain is divided into two hemispheres (there are too many other mechanisms to explore here). The left side of the brain and the right side of the brain are closely interconnected, but in some senses they can operate independently. There are certain types of neurological conditions (like some cases of severe epilepsy) that can seemingly only be treated by breaking unseen conflict between the two hemispheres. There have been occasions when infants below a certain age have had some or all of one hemisphere removed as the result of injury or disease, and yet have gone on to live largely normal lives. In other situations, the left side of the brain has over-compensated when sight has been lost in one eye and the other is covered, by quite literally conjuring a fantom description to fit with what it thinks the brain should be seeing. Without wishing to delve too much further into the deepest workings of the brain, we can summarise that in most adults, with normally functioning brains, the left hemisphere creates descriptions (using words) of the world, based on how it has learned to label things, while the right hemisphere sees and imagines things. Unfortunately, the left side of the brain can be very dominant and has a tendency to overrule the right side. You will probably be able to envisage this yourself next time you look at something for the first time...observe how the left side of the brain will wake up and say, that's a chair, or a car or whatever it is and completely override the right side of the brain. I'm sure you've been on holiday to a foreign country and observed some new scenery and quickly found yourself saying *gosh, this looks just like...* The problem is that once the left side has labelled something, it is very difficult to un-label it. The description biases your real vision. The second problem is that when we want to be do or imagine something new, we turn to the right side of the brain, the side responsible for special awareness and creativity.

In her book, *Drawing on the Right Side of the Brain*, Betty Edwards helps novice artists to go from zero to a convincing self-portrait in a matter of weeks, by getting them to really see what they're looking at without interference from the left side of the brain. Betty uses some insightful tricks and techniques to silence or at least quieten the left hemisphere, allowing us to truly see by focusing on drawing edges, concentrating on spaces and negative spaces, relationships, light and shadow, in small chunks before seeing the whole. If you want to come up with a new solution to a problem, adopting Betty's approach might be helpful if it needs to be something truly original. To aid and abet Betty Edwards, and for a really fun read, I recommend Rory Sutherland's *Alchemy: The Surprising Power of Ideas That Don't Make Sense*, which is dotted with fascinating notions and examples of things that succeeded when perhaps logic said they shouldn't.

We will end this brief insight into creativity by finishing with a highly effective methodology, known as the Disney Creative Strategy. It does require getting into

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the right mindset, freeing up your brain and getting really expansive with your thinking – you need to be three people in one. It can be conducted by an individual, as Walt Disney designed it, but at today at Disney University, they do it as a group exercise to unleash its full power. They also use plenty of space for the exercise to help free the brain, using a different room for each stage to create demarcation between thought processes (if you're on your own and are limited for space, you can use different chairs in differing areas). Ideally, break the process down into a preparation stage and a walk-through stage, and give yourself plenty of time – don't rush it. It can also be helpful to have someone facilitate each phase and note down what comes out of the discussions at each point. In order it looks like this:

1. **Dreamer:** *All things are possible* mindset. Brainstorm without limits – go nuts with it, assume *if it can be thought, it can be done*. Ask *what is the purpose of doing this? What does success look like in this context? Where do you want to get to? Who do you aspire to being like? What areas are you going to consider?*
2. **Realist:** Takes the ideas of the dreamer and says *how are we going to make these dreams a reality? What are the specifics? How possible is this? How will we know we've been successful? What time frames are we working towards?*
3. **Critic:** Chance to enhance and improve. *How possible within the timeframe? Are all parts necessary? What's missing? What elements seem out of place? What concerns remain?*

This can be applied to create any sort of new idea and solve virtually any problem – why not practice and give it a go on something small that you're wrestling with, or dive straight in and invent your revolutionary new idea today?

Here's a brief mock-up of the process in action, if I were doing it for *Galleria Hotels*:

1. I want to help people connect. I want people to feel safe, to be able to speak with each other and collaborate, even if they don't know each other. I want the main room to be a big open space to help sharing of the vibe and community atmosphere. Hotel rooms provide security and a refuge, I don't want to lose that. I want people to feel connected to the location they're in, not just another cookie-cutter hotel. I want people to come to work, rest and play, from far and wide.
2. We can put all the hotel bedrooms around a central atrium, with a stage on the ground floor in the middle as a hub of activity and energy. We can take the desk and work area of a hotel bedroom and put it in front of the room instead of inside it (like a beach hut), then people can meet at the bedroom without feeling embarrassed that they're entering someone's personal space. We can make the whole space a members' only space – and when you stay,

you are a member for the duration. We can have monthly drop-in memberships for local people to come and hang out, use the bar and restaurant or co-work.

3. All of the elements seem possible, but how are we going to deliver it at the right price, could we use modular construction? Should we put office-style turnstiles at the entrance to enhance the feeling of belonging and membership, or will this make it seem cold and unwelcoming – maybe put them after reception? How can we make this more environmentally friendly as a construction process and operation? What about health and well-being? Should we put a walking track on the green roof and a gym in the basement? Will we serve healthy, locally sourced foods and drinks?

## How this Book can Help You

The insights of this book are borne of 30 years of observing the accomplishments of well-implemented and funded plans, as well as the painful lessons of projects gone wrong. Like many aficionados of the hospitality world, I have been lucky enough to work around the world, and in my case, it's been on around 150 projects in over 45 countries, from exotic destinations in the Caribbean to hotspots like Iran, Lebanon, Russia and Somalia. I've benefitted from highly varied experience throughout – running a billion-dollar portfolio of 35 branded hotels for three listed corporate owners, in the middle part of my career, waiting tables at London's Guildhall at my very beginnings to raising capital for my own projects later on. Along the way I've run brasseries and bars, slogged absurd hours in kitchens, welcomed weary guests at luxury resorts, invented new industry sub-sectors and concepts, and raised finance for developments. I've done pretty much everything it is legal and ethical to do in hospitality at some point or other (including writing a *how-to book* about it). Working with major brands and independents alike, I've been intimately involved through all the stages in the lifecycle of a hospitality venture, from cradle to the grave.

What's unique about this book is that the experience from where these insights come, is rooted in deep knowledge of all three of the fundamental legs of the hospitality stool – real estate, operations and investment (the *place*, the *purpose* and the *profit*). Additionally, with a 4-year Bachelor's in Hotel & Catering Management, an international MBA in Food & Agribusiness, and an MSc in Money & Banking, I've bathed in the theoretical complexities promulgated by sesquipedalian academic brains. In the round, I have attempted to distil the essential kernels from the husks of the superfluous, and turn them into practical tips wherever possible. On an intellectual side point, English majors may take umbrage with my use of the indefinite article 'a' rather than 'an' in front of *hospitality* – for me the 'h' of hospitality is hard, so can comfortably carry the 'a', plus I tend to write as I speak...soz.

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The wonderful realm of hospitality is complex and as with any large population, is constantly evolving and is therefore infinitely diverse. There are manifold laws and regulations governing it to varying degrees of enforcement in each of its numerous jurisdictions. As varied as the industry is, so too are the different readers with their legion of different expectations and reasons for buying this book. This makes the creation of a universal manual in under 1,000 pages impossible. However, there are some fundamental principles that apply across boundaries. So, with all of this in mind, and in an effort to impart any wisdom effectively, I have chosen to write what I would call a general guidebook on how to develop a successful hospitality business. As with all *good* guides, I believe there should be a step-by-step framework, a balance of constructive advice, common practices, protocols, methodologies and techniques, as well as warnings of particular dangers that exist *en route*. I am confident you have already and will continue to learn many lessons while on your own journey, which in time, I implore you to celebrate and share...for your own therapy and for the benefit of others. In the meantime, let's see if I can help you avoid making some of those same mistakes.

Overall, I have tried to make this handbook accessible to as wide an audience as possible, while still being useful to technicians and seasoned professionals, from anyone of the real estate, operations or investment silos. If you come across a section that you feel is too detailed or of limited relevance to your individual circumstances, please feel free to skip it or consider it as more general reading.

The only exception to this: please read carefully through and answer the self-discovery questions at the end.

The hospitality industry is easily and often *misunderestimated* (GW Bush, 2000), and answering these questions, though unashamedly tough, is essential before you embark on your voyage. If you are a practitioner of the SQ3R comprehension method (Survey, Question, Read, Recite, and Review) and feel you've surveyed enough already, by all means jump to the questions now. I only ask that before you actually answer them, you take your time to read, review and digest everything in between. When you're ready, find a quiet spot, take a slow deep breath and answer calmly. Remind yourself that whilst pertinent to your circumstances and aptitude, these questions are not personal - they do not imply assumptions or bestow judgement. They are merely an opportunity for objective reflection and you should try and avoid an emotional, or limbic reaction.

Ultimately, if you do decide to go for it, it is you that must build your hospitality business and it will be your hard work, your relationships and probably your capital at stake (at least in part). While I am developing a unique hospitality venture investment fund specifically to support entrepreneurs like you (in part from the proceeds from the sale of this book), I can't do the work for you – this is your play.

As inventor Thomas Edison said, '*Genius is one percent inspiration and ninety-nine percent perspiration*'. Your great idea needs to be expanded upon, developed and turned into a plan that must be implemented if it is to move beyond being just an idea...and that takes time. Indeed, billionaire Jeff Bezos is credited as saying, '*All Overnight Success Takes About 10 Years*' (2018). While this quote has also been attributed to Tom Clancy, it's entertainer Eddie Cantor's version (1892–1964) that demonstrates time never stands still, as for him '*It takes 20 years to make an overnight success*'. I guess humans have halved success time or, as our parents remind us, times were much harder in their day! Maybe you'll halve it again – either way it will take time, so be ready.

If you decide that this is not a journey you want to continue on, fair enough, but keep reading anyway – you might glean a titbit or two, or an insight into the complex workings behind the seemingly simple process of your *oeuf dur* arriving before you at an Instagram-able little café in the City of Light. If it turns out hospitality is not for you, this small purchase may have just saved you the heartache and possibly a load of money too. If, on the other hand, you're not put off and are positively thrilled by the prospect of a new project in the hospitality space – read on and let's see if we can save you a heartache and possibly a load of money too! Good luck!

Before we get into the main body of the book, and while I have your attention on the possibilities of the journey at hand, I feel it's important to briefly address the AI elephant in the room. Artificial Intelligence can provide useful support to creators and marketers alike, it can even automate or simplify some operational processes. In time, if it stops listening only to itself and learns from learned humans, it may be able to do much more. Regardless, I urge you not to shortcut and plagiarise a computer in your mental exercises. I've been appraising hospitality opportunities since the late 1990s, and it still usually takes me around three days get to the true essence of the proposition I'm investigating. Even in the most familiar and mundane locations, I often find that I am positive about the project on the first day, generally more negative by the second, and back to a more balanced, but positive view (that sees the potential in context) by the end of the third. It takes me time to ingest the information, particularly the more subtle snippets that have been gathered, processed and stored in the subconscious. I'm never 100% happy with my conclusions until I have completed the write-up, usually about two weeks after my field trip. Information takes time to harvest, settle and requires involved, active distillation – there are no shortcuts. Give your *actual* intelligence time to absorb and process, and do your research first hand whenever you can.

Finally, I should note that throughout the book, I refer to two hypothetical projects, as examples of the two main areas of hospitality, the Galleria Hotel (to represent overnight accommodations) and Brewbaker's Bistro (to illustrate food

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and beverage offers). Whilst *Galleria Hotel* and *Brewbaker's Bistro* may have taken some inspiration from concepts I have developed under different brands, or be in use as names for existing businesses, these and all other names, characters, and incidents portrayed herein are fictitious. No identification with actual persons (living or deceased), businesses, places and/or products is intended or should be inferred.

Separately, the principles demonstrated in any of the Galleria, Brewbaker's or other examples may be applied more broadly – most hospitality operations are a variation on a theme and are underpinned by common appraisal and measurement methodologies. If one comes across a hospitality business that is unfamiliar or not textbook, nine times out of ten it is a matter of identifying the anchor metrics of the venture in question. These tend to relate primarily to revenue first, typically in terms of volume and value – i.e. how many customers will I receive and what is the average price they'll pay? Different types of hospitality business have their own specific metrics or key performance indicators (KPIs). For example, hotels measure occupancy and average room rate, while in restaurants they may consider average spend and number of customers, often per hour. A waterpark's KPIs might relate to daily visitor numbers and average ticket price. Hostels, by comparison to hotels, might calculate occupied beds rather than rooms. The volume and value quantifications are often combined into a revenue per available 'xyz' figure. Gyms and other membership-based models, will consider revenue per member and membership churn (the rate at which resigning members are replaced by new member sign-ups). Co-working is a good example, using the same revenue per available desk or seat. The only additional complication is factoring in *full-time equivalents* in situations when a proportion of members have restricted hours (peak and off-peak) or part-time memberships.

After revenue measurements, come the operational cost metrics, also usually measured in broadly similar ways across business types. I tend to work broadly in line with the Uniform System of Accounts for the Lodging Industry (USALI), which aims to categorise revenue by department, whether that's *Rooms, Food and Beverage, Leisure and Spa, Minor Operated Departments* (which might include a spa or gym if they're not worthy of their own individual entries), or *Rental and Other Income*. This approach to identifying revenue generation by department is useful because it allows you to see where your main income streams are, and how they are doing from period to period – why room sales are down this quarter compared to last etc. USALI continues this departmental method into the cost areas too, allowing you to quickly see where you're making money and where you might be losing it. The cost areas, by department are typically: *Cost of Sales* (the cost of raw materials like unprepared food items), *Direct Expenses* (such as cleaning products), *Payroll* (your departmental people costs). Your departmental costs (which over-simplistically might be thought of as your variable costs i.e. costs that vary directly with the volume of business you do) can then be subtracted from your

revenue line items to give you your *Departmental Profit* – you can instantly see which departments are making you the most money and which are losing you money – useful! From your departmental profit, is deducted what are known as *Undistributed Expenses* (or overhead costs i.e. senior management, marketing, energy and utilities, repairs and maintenance, and so on that are shared by the whole business and cannot be directly attributed to a single department).

Once you've deducted Undistributed Expenses from Departmental Profits you end up with the key operating metric of *Gross Operating Profit* (not to be confused with *Gross Profit*, which is simply revenue less Cost of Sales and often referred to as *GP* or your product margin). Gross Operating Profit or *GOP* is important because it represents the profit in the operating business that can be affected by management, before non-operating deductions (rents, sinking funds, building insurances and property taxes). Incidentally, if you take these deductions from *GOP* you get to the mystical *EBITDA* or *NOP* (Earnings Before Interest Taxation Depreciation and Amortisation, which is the same things as Net Operating Profit i.e. the clean, clear profit from the business before financing costs, which will vary from enterprise to enterprise for a variety of reasons, many of which do not pertain to the underlying business, but the business owner). We will talk more about USALI and management accounts when we learn to build a profit and loss account later on in the book.

Finally, on the numbers, we get to measurements relating to acquisition or disposal of an asset that tend to initially be spoken of in real estate terms, such as yields and capitalisation rates, before merging with finance and going into a world of analyses on *Return On Investment* (*ROI*), which boil down to profit on cost, *IRRs*, *NPVs* and so on – again we'll cover these later. The point is, it doesn't matter what subsector you're considering getting into, all functioning hospitality businesses generate some level of revenue, from which operating expenditure (*OPEX*) or costs are deducted, leaving a net profit that gives a return on capital expenditure (*CAPEX*) or the upfront cost of buying, building, refurbishing or renting your premises...whatever they happen to be (whether it's a converted trailer or 301 Park Ave, NYC). You'll need to get familiar with all of these metrics and terminology so that you can project income and profit for your given venture. My aim is that by the end of this book, you'll be sufficiently comfortable to be able to do so with some degree of accuracy and with assumptions that can stand up to the reasonableness test. All will become clear.

# Chapter 2

## 3Ps: An Introduction

### The Pillars of the Hospitality Business

#### Introduction to the Hospitality Industry

It is apparently a widely known *fact* that six out of ten hospitality businesses will not survive their first year, and eight out of ten will fail in under five years. It is my experience that before you even get to the first year, eight out of ten projects never reach opening in the first place – on that basis just 4% of hospitality ideas make it through from kernel to stable maturity (or five years plus in terms of business). Ultimately, you've got to get a lot of things right to be the one in five to have a chance of being the one in five! At the same time, around 78% of non-business owners reportedly want to become entrepreneurs, but don't know where to start. Yet there are already in excess of 582 million entrepreneurs in the world. If you are one of the 78%, bear in mind that according to the Small Business Economics Study (2023), 'Entrepreneurs that take the time to create a plan for their business idea are 152% more likely to start their business'. Planning is the key 'P' of the 5Ps! (Proper Planning Prevents Poor Performance).

Some of the upcoming concepts can get a little esoteric or theoretical, so before we start, let's leave the philosophical to one side and keep it simple. Which is probably best done by starting with a working definition of hospitality, and the Oxford Languages version (easily found with a Google search) is as good as any:

Hospitality: '*the friendly and generous reception and entertainment of guests, visitors, or strangers*'.

If you look behind this definition, you've got what I consider to be two of the three ingredients that need to be *activated* in order for an offering to qualify as being *hospitality*:

1. **PLACE** – the *Reception* of someone at your location (the reason why they're called *guests* and not *customers*) and;
2. **PURPOSE** – the *Entertainment* i.e. the people side of things – the *purpose* of both the *customer* and the *entrepreneur*; it's the customer's *why* and the business' *answer to that why*

Then comes the differentiating factor that transforms *hospitality* from a purely social activity or hobby to a business...

3. **PROFIT** – one motivation is to make 'a return on investment' (which can include non-financial returns, too). It is the commerciality or '*intending to make a profit*'. The intention of making a profit implies '*a financial gain...the difference between the amount earned and the amount spent in buying, operating, or producing something*'. Don't forget, your time is an investment, not least as it is time forgone that could be used to do something more rewarding. People, whether they are you, your customers or your staff, are vital to the integrity of your brand and the success of your operation, but don't be distracted by misleading statements like 'people over profit'. Not only is this comparing apples with pears, it's a nonsensical misdirection (unless you happen to be planning to create a heartless, multinational on day one), and fails to acknowledge that without profit, the public need goes unsatisfied and there are no jobs for the *people* to do.

Now we that we've got a new set of Ps: the three Ps of *Place, Purpose & Profit* (not the 6Ps of planning or the 4Ps of marketing – it's ok, we'll discuss these later too) and to distinguish between other purely product or service-based businesses that aim to make a *profit*, hospitality has to have both the *place* and the *purpose* to be true to the definition. It's the *place* and the *purpose* working in harmony that creates the all-important *guest experience*.

The attributes of location are as integral to a hospitality offering as the *entertainment* or reason people go there. This is unlike the majority of product or service-based businesses, which can be packaged up and transported, either physically or electronically, to the end customer. People always consume the hospitality offering *in-situ*. It is their *purpose* (reason for being there), in combination with the qualities of the *place* that completes their experience. In this context and by way of an example, delivery food is ordered from your location, be it home, office or elsewhere, and it turns up at the specified address. Now, while the purpose is fulfilled (food service), it is dropped off and consumed at *your* place, not the venue where it came from. Therefore, while the panting Lycra-clad delivery

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agent may offer some exceptional service and a winning smile, at least 50% of the experience is missing – it therefore cannot truly count as hospitality.

This is not to say that deliveries aren't potentially good businesses, answering a customer need. Such operations, are instead hospitality support and service businesses, many of which represent very sound businesses. A takeaway-only food enterprise may have such a strong brand or quality offering that its sub-par location can be ignored, while a restaurant in the same location would struggle. In some instances, services work better than their hospitality counterparts. The need for location can restrict the availability of suitable sites or impose restrictions on a hospitality business that a service offer doesn't face: look at the success of dark kitchens that produce branded food items, often from less visually appealing, light industrial sites or business parks. Indeed, there are hotels and restaurants, who have set-up delivery services from their existing kitchen facilities in an attempt to increase sales, spread the overhead cost and maximise operating efficiencies.

Whilst providing services to the hospitality industry might not specially be *in* hospitality, they should give food for thought as you begin to shape the nature of your own offering. At this point, I'd just like to draw your thoughts to the old adage: *in a gold rush, sell shovels*. This dates back to the 1849 California Gold Rush, when multiple prospectors attempted and fewer succeeded in striking it rich by panning or prospecting for gold. While Levi Strauss may have sold blue jeans, not shovels, his approach was to provide the tools to do the job, in a longer term, lower risk, lower return, more reliable strategy, as it turned out. Maybe your business idea is one of these too, or maybe an idea will come to you as you read further about the workings of the hotel and hospitality industry. Either way, keep your eyes and mind open, don't stop reading or learning – you'll find useful nuggets everywhere along your journey to help you define your idea.

Getting back to our definition of hospitality, the *place* can be pretty much anything, whether it's a converted horsebox with a few picnic tables and a smattering of gingham, or a luxury Caribbean resort with a golf course and swimming pools in the plural. The *purpose* can also come from a cornucopia of routes, such as business people, leisure groups, conference attendees, and airline staff, all with different reasons for being with you in your place. The delivery of the offering can also vary hugely, with a broad range of service styles, from a receptionist's simple '*good morning*', to the performance of a '*Murder Mystery*' weekend break.

It is not uncommon for back-of-house slogans to prompt staff to 'Smile! You're *on stage*', advice which can give you something to think about when you consider the type of experience you'll deliver: what degree of theatre will you offer as part of your customer experience? Does it fit with your price point? Keep these thoughts at the back of your mind as we proceed. I discovered when consulting

with a start-up gastropub that in the area of hospitality, largely because you're interacting with people, whether they are customers or staff or others, and simultaneously trying to regulate your own stresses and emotions, there will barely be a day or shift that goes by where there isn't a drama of some sort. This is why so many reality TV shows, fly-on-the-wall documentaries, and Christmas B-movies are set in hospitality venues and make such good viewing – it's dynamite-drama! Just think about the programmes you watch – there's usually a service-kitchen, pub, bar, restaurant, guest house or hotel as an anchor location that hosts people under pressure. So when you're called upon to manage the current crisis, remind yourself that however serious this one is, there will be another one along soon that will also need your attention. I'm not saying don't take these seriously: do, just don't let the pressure get to you by finding a coping mechanism (again, don't take things personally unless it is something you've done or failed to do, in which case, face up to it, make it right and move on).

Now back to the main focus of the book and as discussed, the constituent parts of a hospitality business are the place, the purpose and the profit. A solid understanding of what each of these means in practice is vital to your success. In the following pages, we'll delve a little deeper into all three.

# Chapter 3

## P1: PLACE (Real Estate)

### The Physical Space Your Business Occupies

#### Introduction

If it helps, you can simplify real estate and think of it as part of the supply side of the hospitality equation, i.e. it's the physical space and how you transform it to create your tangible product offer. It's the *place* where you welcome your guests. All of this might sound obvious, but what people may not realise is that when they get into the hospitality business, to some degree, they're actually also getting into the real estate business. There's nearly always significant money attached to the real estate, and if you're successful in your operating business, you're ultimately adding value to the underlying real estate – somebody is getting rich somewhere, let's try and make sure you're getting your fair share. The key is to try and make sure you're making the money that reflects your investment and effort. If you bought the building and paid for its refurbishment, you'll want to see a return (or *profit*) that reflects your investment. If on the other hand you're a tenant of someone else's newly refurbished building, you'll expect to pay a fair rent for the opportunity to run your business from there. Above and beyond your rent, you'll be right to expect to take what's left as your reward for taking the risk on the business side of the venture.

Real estate investors invest in land, bricks and mortar (or glass and steel) for a return, across a spectrum of real estate asset classes – it's the focus of their entire business, it's what they do. Within this division of investors there are broadly

two types, the long-term holders of land and buildings, and the short-term speculators and developers of property. The long-term holders of land are usually pension funds and large institutions who like to invest in tangible, stable, illiquid assets (i.e. assets that take time to sell and convert into cash, unlike bonds or other securities that can be traded in an instant). It is expected that these investments will pay out consistent sums of money (whether from rent or net proceeds of the operating business after all management fees are paid). These investors might hold an asset for seven to ten years or longer. Meanwhile, the developers and speculators tend to think in much shorter timescales and this reflects the perception of risk and return: a developer will take a chance on developing land on the basis that after the costs of development, they can make an adequate profit (we'll talk about this in greater detail later in this chapter). Developers might buy a piece of land, develop it and aim to exit out of their position within one to three years (depending on the scale of development). This is partly because development is seen as being risky – material prices can go up, labour costs can run high and market demand can change quickly. This perception of risk in turn means that the costs of finance are higher. In simple terms, the longer you hold the asset the more your finance will cost and that eats into your development profit – hold it too long and it will wipe out your profit altogether (plus financiers will start to get anxious and start asking for their money back if the programme over-runs).

Neither group of real estate investors typically runs hotels or hospitality businesses, they leave that to the operators or management companies who are expert at it. Because the *product* is consumed at the real estate location where the hospitality enterprise is conducted, the value of the underlying real estate is normally contingent to some degree on the performance of the business. Simply put, the better the business does, the more rent a landowner may charge (subject to local laws) and therefore the higher the value of the property. Similarly, where the owner and the operator are one and the same, the better the Net Operating Profit of the business the better the valuation. For this reason, hospitality real estate investment is usually left up to specialist firms who understand the nature of the hospitality industry. Equally, larger, more broadly focused real estate investment vehicles may well employ a specialist hospitality asset manager as their expert, who understands both the real estate and business components. The asset manager sits in between the owner and the operator, and runs the relationship with the operator, ensuring good performance and legal compliance. Simultaneously, the asset manager is tasked with *sweating* the real estate asset (i.e. making it work as hard as it can, e.g. by adding bedrooms and amenities, remodelling and refurbishing existing facilities, such as a telecoms mast on the roof or a new concession in the lobby, and signing new tenants,).

Conversely, if a publicly traded hospitality operator starts making investments in real estate, rather than in their core business of running hotels, analysts at investment banks will start downgrading their valuations of the stock. This may seem

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strange to most of us, as we'd think that if the operators owned their buildings, they would make more money and therefore be more valuable as a company. The reason it makes sense, however, is that running a hospitality business involves spending money on intangible assets like branding, and on activities that drive revenue or improve profitability, like sales and marketing, or purchasing and cost control. These items are generally of lower value because without the business they are effectively worthless – if the operator went bust, an insolvency specialist would have little to sell to pay off any outstanding debts of the company. As a result of this perceived lack of security, the cost of the operator's financing is generally higher than for the purchase of a real estate asset such as a hotel. Think of the interest rate on your or a friend's mortgage, which is usually set at one to three percentage points above what is called bank rate, compared to the interest on your credit card, which is normally at +20 percentage points above bank rate). The good news for the operator, however, is that they typically need considerably less funding to pay for a rebrand than a real estate investor does to buy a hotel, precisely because they're not buying the underlying asset. While the operator must therefore make more money per dollar of investment, they need many fewer dollars in total. The hotel investor on the other hand, usually aims to make less money per dollar on many more dollars of investment, typically consistently over many more years. It is really fairly logical: real estate investing is about investing in real estate, while running a hotel is about managing people and delivering a guest experience.

The reason for labouring the point and making the distinction between the two investments (assets vs operations) is that it changes who you might go to for funding, the levels of return investors might expect, and the cost of any finance you secure. What business are you going to be in – do you develop properties, or do you run them? Are you going to be one of those unusual creatures that is an owner-operator? If so, you may well find that you have to be your own bank, and in this case, is an asset-backed hospitality business the best place for your investment to get the returns you're looking for?

### **Tenure & Title (how land/buildings are held/occupied)**

While the distinction between real estate and operation is fresh in our minds, now is probably a good time to have a quick look at how buildings (or land) is owned or occupied. Over the past few pages, I have used terms like lease and rent to capture some of the varying relationships that exist between ownership and occupation, and in the remainder of the chapter, we will talk some more about this. Much of this area is governed by local laws that would become impossibly complicated to discuss fully here. There are, however, some umbrella concepts that are relevant in most jurisdictions, which I will try to elaborate on. The following is not, and is not intended to be comprehensive, but more of a way of thinking about real estate. My advice is to consult a skilled and recognised professional practitioner in the country in which you're going to operate.

Essentially, there are four different ways for an individual or a corporation/company (a business that is a legal entity in its own right) to legitimately possess or occupy a premises:

- i) Freehold – or sometimes a '*fee simple absolute in possession*', is where an entity has outright or absolute ownership of a piece of land and a building on it for an unspecified amount of time. The details of any holding will be contained in written *deeds* or *title* documents, usually recorded and held by government. On which point, if you are an English reader, you may have heard of the Domesday Book (1086 CE), commissioned by William the Conqueror some 20 years after his victory over King Harold at the Battle of Hastings. The original Domesday Book was a manuscript that recorded the findings of the *Great Survey* of England and Wales, when the King's agents were sent out to survey every shire of the nation, in order to list his holdings and the dues owed to him (primarily a list of who owned what lands and who lived there). It was a huge undertaking, and was the first of its scale in Britain. Also known as the *Liber de Wintonia* (The Book of Winchester – a town that was the seat of the new King), Domesday was originally kept in the royal treasury, which illustrates its importance and purpose – a way of knowing what taxes were owed to the crown. The findings and decisions contained in the Book were unalterable, like those of the Last Judgment or Judgement Day, which is where the name *Domesday* comes from. As they say, there are only two certainties in life, death and taxes – it seems some things never change!

Back to our freeholds, in the UK, the rights of ownership conferred with are generally considered to extend down to the centre of the earth and up to the '*lower stratum*' (circa 500ft to 1,000ft above ground), although it should be said that while rights to minerals contained therein, or sporting rights (i.e. to hunt) are normally included, this is not always the case. It has been known that an owner will sell off their *air rights* (the space immediately above the property). This is most common when a developer intends to build a block of apartments and sell each one as a freehold, for example (also known as flying freeholds). The problem with this is that while the apartment is sold as a freehold, there will need to be multiple covenants (civil laws specific to the real estate) and warranties to protect owners beneath. In these cases, more often than not, a developer will sell a share of the freehold of the land (typically by issuing shares in a company that owns the freehold) and offer the building that sits on it a long lease with a small rent (we will come on to leases in just a moment). This arrangement can then itself be further complicated if the company that owns the freehold is then also charged with maintaining and insuring the common areas of the land that surround the building(s). In which case, there will likely be an annual *service charge* to cover the cost of doing this. Back to the point, the important thing about a freehold, is that you own the land or building outright with no ongoing costs (other than local property taxes) and this is usually what a real estate

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investor wants. There is not normally even a requirement to maintain the property (although some local governments enact rules to make sure this is done to ensure the aesthetic environment is upheld – this may also be done through covenants written into the title deeds). It is also the underlying asset that a bank will lend against (they will place a charge on the asset and take control of the title deeds). If you default on any loan payments where the bank has taken the property as security, they will repossess it and kick you off *their* land! Freeholds are normally the simplest way of holding a real estate asset and provide the greatest reassurance for investors, as they can be most easily sold in an emergency to get at least some of their money back. As a result, freeholds are also normally the most expensive way of holding real estate. Note that freeholds with vacant possession are often considered the most valuable real estate because they are open and available for the widest possible market of buyers – a freehold with a sitting tenant will only be interesting to an investor who wants the property for the rental income, whereas if it is vacant, it will be potentially interesting to developers and business operators, as well as still being of interest to investors who wish to install their own tenant after the purchase.

- ii) Long Leasehold – is the exclusive right to possess or occupy land for a fixed term. A long lease is considered to be for more than 80 years; anything less than this would generally be considered a short lease. Often you might find long leases run for 99, 125 or 999-year terms. Usually, but not always, the longer the term, the lower the annual rent and the higher the initial capital cost (purchase price). So a 999-year lease (also known as a virtual freehold, because the term is so long) might operate on a *peppercorn rent* (a matter of a few hundred pounds each year), while the price to buy the long lease holding will be similar to that of a freehold (likely a few hundred thousand pounds). A shorter term lease, of say 30 years, will probably have a much higher annual rent (several thousand pounds per month), but will cost much less to buy in the first place (maybe a few tens of thousands of pounds). As with any lease structure, there is always a landlord (who owns the freehold) and a tenant, who owns the right to occupy the land/building for the fixed period. Indeed in the UK, the legislation governing leases is contained within the Landlord and Tenant Act (+ amendments) and/or the Housing Act (although the former is primarily concerned with short leases in residential property). Long leases are a favourite of property developers who construct *estates* comprised of multiple houses. The construction firm will usually sell a share of the freehold that the estate occupies and then sell the house itself on a long lease. There is some security with a long lease (which is why people are able to get mortgages on long lease hold properties), but it is a more complicated ownership structure than a freehold and it does mean that someone else ultimately owns the real estate (even if they have no rights to occupy it for many years to come). Leases also typically come with the responsibility

of paying an annual rent, as well as sometimes insuring the building and maintaining it.

- iii) Short and/or Commercial Leasehold – Residential, occupational and institutional leases or some variant in between. You will probably be familiar with renting a house at some point in your life and residential lettings are a whole area of specialism in themselves. For this reason and because residential leases are not entirely relevant to your business, I won't give them too much time here.

**FRI OR INSTITUTIONAL LEASES:** so, on to *institutional* leases, which are normal leases, but are applied to properties designed to be appealing to the institutional investment community i.e. big banks, pension funds and so on. The reason these lease structures are *institutionally* palatable, is that they tend to be *FRI* or *fully repairing and insuring*. In other words, the tenant bears all of the responsibility for maintaining and insuring the entire property. This means that the management of the property is as hands-off as possible from the investor's perspective. You will also find that the lot size (size of the investment), location and covenant strength of the tenant, are also considerations that institutional investors will consider. What institutional investors prefer, are investments that are more easily traded and appeal to the widest possible market of qualified buyers (entities they know have the funds/ability and motive to buy) – the more buyers, the more the competition for the asset and therefore the higher the perceived value. Institutional investors usually have plenty of capital to make acquisitions, and are normally considering multiple buying opportunities at one time. These opportunities all take about the same amount of time to process (conduct *due diligence* on, transact – go through the legals, and so on – sometimes known as underwriting), and so will not waste time on smaller deals; hence, *I wouldn't get out of bed for that deal* (it's too much effort for the return).

For reference, *underwriting* is the process of assessing and evaluating the risk associated with making an investment, including inspecting its physical condition and the likely need, timing and cost of future repairs (*underwriting* as a term is also used by banks offering loans, firms making other securities investments or issuing insurance policies). As an aside, when it comes to hotel investment, an institution will tend to prefer a portfolio deal (e.g. buying a chain of hotels) rather than purchasing a single, very large asset. This is because of a) the deal size, and b) the diversification of risk i.e. the investment is spread across multiple assets that can be disposed of individually if needed. From an investor's perspective, they get a big deal size with lower risk, and consequently will often pay more for it. Location is another important factor in the equation for institutions, again determined by the likely number of buyers when it comes to sell. So while London and New York are long-term favourites, Austin in Texas might have to be flavour of the month for a few years before it becomes *institutional*.

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The final component is *covenant strength* or simply *covenant*. Which really just means the substance behind the tenant and therefore their ability to pay the rent – a publicly listed company will normally hold a cash buffer and if needed, can usually raise more, relatively easily to cover the rental payments. At the other end of the scale, in commercial real estate terms (i.e. property that relates to business activity, as opposed to residential) are OCCUPATIONAL OR TURNOVER LEASES. These leases usually have their rent set as a percentage of turnover i.e. a restaurant might be on a turnover lease, where the rent is set at 20% of revenue. In a scenario such as this, it is likely that the external building will be insured and maintained by the landlord, while the tenant will insure and maintain the business operation and all of the contents (it might be that these *fit out* items are owned by the tenant business rather than the landlord, who merely provides the empty space for them to occupy). There are several advantages of this framework to both landlord and tenant. There is less need for rent reviews, as the rent will increase with the performance of the business (anticipated to be in line or ahead of the broader economy).

Turnover leases have become popular of late with larger investors aiming to hedge against inflation – their gamble is that the business can charge more in the inflationary setting and therefore this will increase the rent paid (this is in comparison to an institutional lease where the rent might not increase until the next review in 4 years' time). There is less risk for the operator/tenant; they must just ensure they operate efficiently so they don't make less than 20% profit on turnover with which to pay the rent. As with other leases, it is not uncommon for a *collar* and a *cap* to be written into the agreement, which is to set a maximum and minimum increase on each rent review. As an example, a collar of 2% and a cap of 5% guarantees that the rent will always increase between 2% and 5% per annum at each review. It is more than possible that you will come across this type of arrangement if you are renting premises for your hospitality business, although such tenancies are less popular with investors (and they will often try and get unsuspecting tenants to sign up to more institutionally acceptable lease before offering an occupational one – the strength of their position and ability to do this will depend from case to case).

Sometimes you might see a hybrid lease structure, whereby the landlord has a certain fixed amount of the rent guaranteed by the tenant, with the remainder above this floating on a turnover basis, which is appealing to the landlord because the guaranteed element of the rent will probably be valued more highly than the floating or flexible element because it is guaranteed.

In the example shown in Figure 3.1, the straight 20% rent might be valued at 10x, so £2,000,000, while the split rent with the guarantee might be valued at 14x for the guaranteed element and 10x for the floating element, so £1.4m and £1.0m respectively, giving a combined value of £2,400,000 (20% more than the rent with no guarantee).

**Turnover Rent no Guarantee**

|                              | <b>£s</b>          |                   |
|------------------------------|--------------------|-------------------|
| Revenue                      | £ 1,000,000        | -                 |
| <i>less</i>                  |                    |                   |
| Operating Costs              | £ 700,000          |                   |
| <b>Profit (before rent)</b>  | <b>£ 300,000</b>   |                   |
| <i>less</i>                  |                    |                   |
| Floating Rent                | £ 200,000          | 20%               |
| Guaranteed Rent              | £ -                | 0%                |
| <b>Total Rent</b>            | <b>£ 200,000</b>   |                   |
| <b>Capital Value of Rent</b> | <b>Multiple</b>    | <b>Exit Yield</b> |
| Floating Rent                | 10.0               | 10.0%             |
| Guaranteed Rent              |                    |                   |
| <b>Total Rent</b>            | <b>£ 2,000,000</b> |                   |

**Turnover Rent with Guarantee**

|                             | <b>£s</b>          |       |
|-----------------------------|--------------------|-------|
| Revenue                     | £ 1,000,000        | -     |
| <i>less</i>                 |                    |       |
| Operating Costs             | £ 700,000          |       |
| <b>Profit (before rent)</b> | <b>£ 300,000</b>   |       |
| <i>less</i>                 |                    |       |
| Floating Rent               | £ 100,000          | 10%   |
| Guaranteed Rent             | £ 100,000          | 10%   |
| <b>Total Rent</b>           | <b>£ 200,000</b>   |       |
| <b>Multiple</b>             | <b>Exit Yield</b>  |       |
|                             | 10.0               | 10.0% |
|                             | 14.1               | 7.1%  |
|                             | <b>£ 2,408,451</b> |       |

**Figure 3.1** Two rent scenarios, one with a guaranteed element and the other without

What is relevant and common to all leases is that they come with the responsibility of paying an annual rent, someone insuring the building and maintaining it. It is quite normal for a landlord (freeholder) to require defects to the property that have occurred during the lease term to be put right before the end of the lease (above and beyond normal wear and tear). Any defects that are *dilapidations*, are effectively breaches of a tenant's lease obligations or the covenants surrounding the property. There are a couple of matters that anyone taking on a lease should be aware of or consider before entering into a lease agreement; these include:

- Knowing the **term** i.e. how long the commitment(s) last for (for both sides), as well as **who** each of the parties is and the **rights** of both parties to continue or **renew** the arrangement beyond the term (right of renewal);
- Being sure the activity you wish to conduct is **permitted** by law in the building or land you wish to occupy. Does it have the correct **planning** designation? Can I make **alterations** to the property?
- Understanding the full range of **responsibilities** (again for both sides), e.g. a business might **maintain** and **insure** the business and building equipment and contents (including stock), as well as carrying public liability insurance (to cover injury to customers), and employer's liability insurance (to cover staff; if the lease is held by a limited company, there may be director's insurance, too), while the property owner may insure

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and maintain the building. In certain buildings, it may be that replacement or maintenance of expensive items like the roofing, is the collective responsibility of all leaseholders – I have seen situations in which tenants had to share the cost of replacing lift (elevator); each had a bill for £25,000! (on top of their monthly rent and service charge).

d. What the **rent** is, in what currency, when it is due and how **reviews** of the rent are to be conducted, e.g. 5-yearly *open market review* (usually still subject to be on an upwards-only clause, i.e. the rent will only ever go up, but is set following a determination from a regulated real estate professional and subsequent negotiation), vs a fixed rate or inflation-linked review, e.g. CPI – Consumer Price Index. While the latter might sound equitable, it is important to realise that CPI has never been negative (even during COVID) and its predecessor, the RPI (Retail Price Index) was only -1.2% for the 12 months ending in April 2009, during the *Global Financial Crisis* and *Great Recession*, which was its lowest since it started in 1948! What is more, before you think well, everyone was in the same boat so how bad can it get?, remember, inflation is not equal across all sectors of the economy – salaries and wages don't always keep pace, either. As a hospitality business owner, you will be subject to some degree to consumer sentiment and the whims of the market place, which are not always accurately reflected in CPI.

Imagine the economy shrinks for two consecutive quarters (the Bank of England definition of recession), i.e. production output or GDP (Gross Domestic Product), driven by reduced demand reduces, but inflation remains above 0%. In this scenario, people spend less in the bars, pubs and shops, while other factors, like an increasing cost of fuel (needed to transport all raw materials to these businesses) keeps the CPI rate high.

The reality in the UK, between April (beginning of Q2) 2008 and the end of June 2009 (i.e. 1.25 years or 5 quarters later) the economy shrank, while unemployment increased to 2.68 million people (or a staggering 8.3% of the workforce). and the inflation rate continued to increase.

| Measure                          | 2008 Q2 | 2008 Q3 | 2008 Q4 | 2009 Q1 | 2009 Q2 |
|----------------------------------|---------|---------|---------|---------|---------|
| <b>Real GDP Reduction Rate %</b> | -0.2%   | -1.7%   | -2.2%   | -1.8%   | -0.3%   |
| <b>CPI % Rate</b>                | +3.3%   | +4.5%   | +3.7%   | +2.9%   | +2.0%   |

**Figure 3.2** Real GDP Growth vs CPI Growth 2008–9 (Note: quarterly figures reflect an annualised rate)

As an example, if you signed up for a lease with a CPI-linked rent of \$3,000 per month (or \$36,000 per year), when average annual CPI was at, say 3.5%, you would find that the rent would increase to \$69,210 per year after 20 years. If your annual revenue was \$360,000 in year 1 and showed an average annual growth of just 1%, it would increase to only £434,920. Your revenue would have increased by \$74,920 (or 21%) while your rent would have increased by \$33,210 (or 92%). Now consider that despite your prudent management, your costs increased over the period by, say 2% per annum (from \$270,000 to \$393,339), your position would look like this:

| Year                      | 2024                    | 2043      | Increase                 |     |       |
|---------------------------|-------------------------|-----------|--------------------------|-----|-------|
| <i>CPI Rate</i>           | 3.50%                   |           |                          |     |       |
| <b>Rent</b>               | \$ 36,000               | \$ 69,210 |                          |     | 92%   |
| <i>Revenue Growth (%)</i> | 1%                      |           |                          |     |       |
| <b>Revenue</b>            | \$360,000               | \$434,919 |                          |     | 21%   |
| <i>Cost Increase (%)</i>  | 2%                      |           |                          |     |       |
| <b>Costs</b>              | \$270,000               | 75%       | \$393,339                | 90% | 46%   |
| <b>Rent</b>               | <u>\$ 36,000</u>        | 10%       | <u>\$ 69,210</u>         | 16% | 92%   |
| <b>Profit</b>             | <u><b>\$ 54,000</b></u> |           | <u><b>\$ -27,630</b></u> |     | -151% |
| <i>Profit %</i>           | <u>15%</u>              |           | <u>-6%</u>               |     |       |

**Figure 3.3** Illustrating the effect of CPI increases in rent vs real world revenue, costs and profit growth over 25 years

You have gone from a healthy 15% (\$54,000) profit to a 6% (or \$27,630) loss.

- e. What **break clauses** are there? Most leases will have very limited opportunity to break (as this reduces the certainty of future rental income for the real estate owner and therefore its value). Owners and investors will therefore try to avoid breaks for a minimum of say, 10 years, but it is not uncommon for them to come into effect every five years after this initial period.
- f. Are there **(re)assignment** rights? In other words, if you wish to exit the situation yourself, do you have a right to sell the opportunity to someone else at a premium, or discharge your leasehold responsibilities to someone else at zero cost – this can be an important feature for small business owners trapped in a loss-making scenario that can transfer the lease to a more substantial company that can bring efficiencies to the operation to run it at a profit. In which case, the small business doesn't go bust, the landlord gets their rent, the new tenant gets access to the opportunity and everyone wins.

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- g. What is the **jurisdiction** of the lease i.e. what country's law governs it and where is any arbitration or legal process going to take place? You may trust the law of your home country, but if you buy a property in another country, you may find their legal structure and processes to be completely different to those of your own (most notably the UK and Europe, where in England and Wales we operate on a Common Law basis, where judges make judgements based on precedents from case law, in comparison to France, where the law comes primarily from statute). Plus, in practical terms, think of the time and financial cost of travelling to a foreign court, securing local legal representation and awaiting determination of your case from a judge, whose legal system is completely different to the one at home...can you even appeal a decision if you don't like the outcome?
- h. Is there a rent **deposit** that must be paid? If so, when, where, and how much is to be paid? These days, deposits are normally held in what is known as an *Escrow Account* (or simply referred to as being in escrow), in which a bank account is operated by a neutral third party. The escrow account receives money (the deposit) and disburses it depending on certain prearranged conditions being met, e.g. if there is a default by the tenant on the rent they owe, their deposit may be forfeited in part or in full, depending on the scale of the default. Equally, the same applies if the tenant fails to *make good* damage to the property. In the UK, it has now become a requirement for private landlords to hold deposits in a separate, independent bank account to avoid abuse of the deposit system. Another common example of the use of escrow, is when someone is buying a property and they are required to pay a deposit into escrow. This is seen as a proper way of handling the deposit, rather than the buyer placing it directly in the seller's account or keeping it in one of their own. If one side then fails to complete on the transaction, in breach of the terms of the agreement governing it, the deposit is either paid back to the buyer or as a form of damages to the seller, depending on who is at fault. Sometimes you will see a rent *deposit pot*, which is dipped into when needed to cover rent shortfalls and is topped back up by the tenant when trading is better; this can be a good mechanism for the tenant to limit their liability to the deposit pot, rather than to the entire rent for the full term of the lease.
- i. Opportunity to **enfranchise** the lease is a right that allows the leaseholder to buy out the freehold and any intermediate leasehold interest, for example, a head lease, without the landlord's agreement. This is usually done at an independently derived, fair open market valuation. The right does not exist in every jurisdiction or in every case, but was introduced largely to help long lease holders to remove the ground rents

on their lease. These were normally held by the developer who built the property and were on occasion subject to outrageous increases that reflected neither market conditions nor any increase in the landlord's responsibilities.

iv) Licence to occupy – in some localities, like the UK, laws have evolved to protect tenants occupying properties on leaseholds from nefarious landlords, who had previously been able to indiscriminately increase ground rents. The new laws enabled tenants to enfranchise their leases (as described previously in point iii); in other words, to convert their leases into freeholds at the prevailing market rate, thereby dispossessing the landlord of their property (albeit for fair compensation). As a result, in many situations where a lease might normally have been granted, the landlord might prefer to offer a licence to occupy that conveys no right to enfranchise. This system has been particularly popular in co-working or serviced office situations. Situations like this are sometimes referred to as being *outside the act* – meaning they are not governed by the Landlord and Tenant Act.

Both leases and licences can be efficient mechanisms for the correct allocation of roles and responsibilities. The landlord (a real estate investor) invests in and owns the land/building, while the tenant (the operator) focuses their effort and working capital on serving customers and running the business at the location. Everyone is theoretically doing what they're good at and investing in what they know.

v) Franchises are an arrangement whereby a company authorises someone else to sell their products and/or services under their brand name, in return for a fee. Franchises boomed after the Second World War as the global economy recovered and grew, but have in their simplest form, been in existence since the Middle Ages, when landowners made agreements with tax collectors to collect taxes for a commission. In the 1700s, this expanded to the operation of ferries, bridges and markets (you will still see examples of these old arrangements in practice in the West of England where an operator may charge a 5p fee to cross a river – the price remaining unchanged for many years because it is regulated by Act of Parliament!). Historic franchises include John Pemberton's drink franchise, an early iteration of Coca-Cola, for which he licenced the bottling and sale to other firms to expand his product distribution and brand reach. In hospitality, possibly the most famous franchise is McDonald's, which successfully continues to both operate its own restaurants and franchise its offer to third parties.

Franchises imply no ownership of, or right to occupy land or buildings, and are very different from the leases and freeholds we have discussed so far. A franchise is essentially a way for a company to expand or grow its business. There are two main parties involved in a *franchise agreement*, the *franchisor* and

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the *franchisee*. The franchisor develops the original business model, including knowledge-based, repeatable operating processes, brand, trademarks and other intellectual property. It then licenses these items for use, subject to compliance with certain obligations, by the franchisee (the party taking on the franchise) in return for a franchise fee. The franchisee does not own any of the items under the licence, but is merely permitted to use them for as long as they are compliant and the agreement remains in place. In practice, this typically means an entrepreneur borrows a brand, famous in their chosen industry, to help them raise their business profile and drive sales, while simultaneously using methodologies developed by that brand to save costs within their operation. The benefits to a franchisor are pretty obvious: they can grow their business and brand recognition very quickly (getting franchisees to put the franchisor's flags in the ground), without using their own capital and at very little risk (other than damage to their brand if the franchisor fails). And there are several advantages to adopting a franchise for the franchisee too; otherwise people wouldn't do it:

- a. Operating a franchise increases your chances of success (in theory, anyway) because you have access to a proven concept and business model. This includes use of a recognised brand name and marketing materials/network (and sometimes referrals), as well as centralised marketing campaigns and public relations/crisis management support.
- b. Readily available technology support and resources (although these often come at an additional cost);
- c. Access to training;
- d. Plug and play use of well-established procurement pathways and suppliers (as an independent, it can often take a long time to source, set up and negotiate terms with your preferred suppliers – indeed, some larger suppliers will not even deal with start-up businesses or will offer unsustainable terms of credit).
- e. Sometimes it's easier to attract investment;
- f. Availability of ongoing advice and business support;
- g. Centralised product development, which can be a definite advantage in the long run.

There are however also some potentially significant disadvantages to franchising for the franchisee as well:

- h. High costs: *Initial* set up expenses – the more successful the franchisor's brand and business, the higher the likely initial cost. High ongoing fees, in terms of royalties to use the brand name, technical services fees (either for pre-development design support or ongoing IT and other

support). It is also quite normal for hotels to pay a central marketing fee to the franchisor, as well as budgeting for their own local marketing activity. There may also be a booking fee (essentially a commission for booking referrals from the franchisor's website or booking system). Additionally, visits from the franchisor's head office team to the property may well be at the expense of the franchisee.

- i. Competition may come from other high-profile brands or even those from within the same stable (there is usually a non-compete clause that prevents another property of the same brand opening within a mile of your operation, but this will usually not extend to other brands from the same franchisor).
- j. Brand integrity and association. Using a franchisor's brand can be a double-edged sword – the brand may be strong in certain downtown locations, but inappropriate in the suburbs, and a PR disaster at a same-brand property on the other side of the world can have knock-on effects to your business.
- k. Conflict between franchisee and franchisor can arise in many areas. Imagine a larger hotel with the same brand as your franchise opens up five miles down the road from your location. The franchise's head office sales team might naturally be inclined to promote and sell the rooms at a new opening hotel more than your existing, slightly tired rooms. As selling rooms requires a similar amount of effort, the central sales team might be tempted to block sell rooms in a larger property to a single wholesaler rather than selling individual rooms to multiple buyers at your smaller property. There can be a lack of loyalty on both sides of the fence as both parties try and squeeze as much from their respective businesses as possible.
- l. Lack of control – there will be brand guidelines that must be adhered to;
- m. Inability to innovate or develop the product offering beyond the brand constraints;
- n. Limited exit options for the business owner. Whilst having a brand on a property may help to drive revenue for the business, it may also limit the value of the real estate at the same time – a property that is unbranded will generally be appealing to a wider market than with a brand attached (this is because the brand may have right to transfer with the property and this will mean it cannot be bought by another operator or brand, or a developer who wishes to use another brand).
- vi) Management Agreements – as with franchises, a management agreement (MA) or hotel management agreement (HMA) bestows no ownership of the brand or real estate (the latter is usually held under one of the arrangements

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mentioned previously). A management agreement is literally just that, an agreement for one company to manage the business affairs of another at their location. Management agreements sometimes include the use of a brand name (and are operated by the original brand-owning company). However, these days, it is increasingly popular for a hotel to be a brand franchisee and use a third-party, *white-label* operator to manage the day-to-day operating business. In either case, a management agreement is normally management for a fee (or several fees), designed to incentivise optimal performance of the business (usually in a number of different areas). The fees are therefore typically structured as follows:

- a. **Base fee** – a simple percentage of revenue, which is designed to encourage the management company to drive sales;
- b. **Incentive fee** – usually a percentage of gross profit (after the base fee has been deducted);
- c. **Non-performance fees** – technical services support, etc.

In addition, where the brand is included in the MA, you would expect to see the fees associated with a normal franchise arrangement (royalty fee, booking fee, central marketing fees, and technical support fees).

I suggest conducting a search of the internet to get up-to-date figures and percentages for scale of fees for both MAs and franchises – be sure they are relevant to the business you are looking at (hotels and restaurants can operate on a very different basis, for example).

As becomes clear, the laws regarding property ownership can become very complex, very quickly, and it is therefore essential to seek professional advice from a chartered or regulated surveyor, lawyer or other real estate professional before entering into any agreement. This advice will likely have an upfront cost, but it might save you from making an expensive or project limiting mistake further down the line.

### **Economic Rents (why some locations are more expensive than others)**

You can't escape it. Your offering is inextricably linked to your location – its attributes are your business' attributes, just as its shortcomings are the business' shortcomings – this is why the old maxim states that real estate is all about *pitch, pitch & pitch*. While we'll see how to improve your pitch later on, to better understand why pitch prices vary, we will first briefly detour into the theory of *economic rents*.

In this instance, we're not talking about *rent* in the normal sense, as in the money you pay to your landlord to live in their apartment or house (although this is

where it has its roots). This *rent* is an economic concept, and in this instance, I'm referring to classical economics more than neoclassical economics. And now you're saying, *hang on, what's the difference between classical and neoclassical economics and why on earth should I care?* Well, in a market-based economy, classical economics tends to look at the mode of production through a historical lens and thereby assumes that *prices* of goods are a function of the *cost of production* (i.e. the cost of raw materials and the labour employed in production). Neoclassical economics, by contrast, argues that *perception of value* by the consumer has a much greater influence on price. The former view was probably more accurate when it was developed in the 1800s, while the latter became more accurate from the 1920s onwards, following the pioneering work on marketing by '*the father of public relations*' Edward Bernays in his publication, *Propaganda*. Bernays used his own psychology and psychoanalysis ideas, and those of his uncle, Sigmund Freud (initially a close colleague of Carl Jung), to manipulate decision-making in the masses for both government and private corporations. His motivation research suggests that the *crowd* is irrational and liable to a herd instinct that reflects current social norms and an individual's deep-seated fears and aspirations. Some consider Bernays' work to be the origin of modern brand marketing, but I digress...back to economic rents...

Simply put, the classical model of economic rents refers to any payment that results from non-production inputs, specifically *land* and its location. Better quality or well-located land is more productive and therefore a higher rent can be charged for it. As an example, land that is rich and fertile because of its preferred location (such as on the floodplain) and produces more crops simply because of where it is – has its quality determined by location, and the rent paid to rent the land reflects its quality, not the seeds sown or the effort put into production of crops (production inputs). Consequently, when the landlord comes to setting the rent, he considers the higher yield potential of the field and adjusts the rent accordingly. The field is then rented to the bidder who can afford it (and still thinks they can work the land to produce a surplus profit for themselves – a return on *their* investment). Historically, castles (or places of refuge during attack) tended to be built near to the higher quality land (crops could be safely stored in the castle) and markets sprang up nearby, where produce could be traded. As a result, lower quality land tended to be located further away from these mediaeval commercial hubs. The lower quality land, like a swamp that is hard to plough and produces fewer crops, in turn is worth less and attracts lower rents than the prime land. Bidders who cannot afford the rent of prime land, take up the next best land they can afford, until the least productive land is rented by the least well-off. However, being shrewd tenants, the holders of the swamp land realise that if they drain it or build up banks of earth interspersed with toughs (ridge and furrow), they can make their rented land more productive – increasing its potential and giving them a better profit after they've paid the rent. Of course, in time the landlord gets wise to the enhanced production and will adjust the rent upwards to reflect this previously poorer quality land's new potential. The tenant is then faced with

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the choice of paying the higher rent, or moving to a new, less valuable plot and repeating the process by spending money to enhance its value instead of paying higher rent on the existing plot.

It is the same principle at work, hundreds of years later, that explains the gentrification of former slums and docklands in our modern urban society. People come to a city for work, and they adjust their home location to fit their budget, with the poorer paid pushed further away from their place of work (the monetary and time cost of commuting being less than the rent or purchase price differential). In time, they enhance their houses and the area, by demanding better quality shops and services. This in turn pushes up what landlords can charge in rent and squeezes existing occupiers' budgets – who face the choice of paying higher rents or moving further away.

Today, there is a question hanging over the real estate world, as to whether this mechanism will continue to work following the global pandemic that taught many of us that we could work from anywhere, including our homes (*Work From Home*) and so didn't need to pay higher city rents. The significance of this cannot be understated, as it potentially reverses the rural *hollowing-out* that has been in many countries, as people moved out of rural locations to the bigger cities in search of work. Of course, the jury is still out as to whether *remote* working is really sustainable in the long term. Does our mental health or productivity miss the serendipitous spark of collaborative co-working that was *the future* up until the pandemic? Will we see urban hollowing-out? It seems unlikely: large firms are heavily invested in their office real estate and will not want to see that value evaporate before their eyes (hence *return to the office* mandates, particularly from real estate advisory firms!). The spin-off businesses that provide support services (like bars, coffee shops, hotels and restaurants – most local hospitality businesses) would also be severely impacted by their customers disappearing into thin air if there were to be a permanent shift to WFH. The rise of *hybrid* working is at least recognition that there may need to be some form of compromise, and the success of any compromise is dependent (in a free market) on the compromise being better than any of the alternatives – we will see. To be clear, in the modern world, the economic terms of *rents* or *rent-seeking* refer disdainfully to individuals or businesses who look to gain higher income from non-production inputs, often in the context of nefarious acts or as taking unfair advantage of a situation.

Obviously, the reason I mention the role of the classical economic rents mechanism here, is because it is of potentially great significance to your fledgling business – will you be able to afford to be in or near to a ready-made market, in a desirable location (where your customers are readily found), or will you have to go off pitch, enhancing your *place*, become a destination and draw customers to you? Indeed, will those markets look the same in five years' time? Will hybrid working take over the world, such that we're all heading into a city office from our cheaper,

remote rural home twice a week, and thereby increasing our need to stay in an affordable hotel each time? Imagine the boost to country bars, pubs and shops at the home end of our bi-weekly commute if this were the case. Or will the opposite reoccur with *hollowing-out* of rural towns? It becomes incumbent upon any hospitality entrepreneur to understand, keep abreast of developments, and try to stay ahead of trends in the real estate sector. A turn in the market, or a poorly conceived real estate strategy can cost a business its existence in some circumstances.

Whilst originally observed by economists of the 19<sup>th</sup> century, the economic rents concept actually dates back to the end of medieval feudalism in the late Middle Ages. The Middle Ages ran from the post-Roman period around the 6<sup>th</sup> century, to the 15<sup>th</sup> century and the fall of Constantinople (1453), Columbus's first voyage to the Americas (1492), and the start of the Protestant Reformation (1517). Under the feudal system, the Crown gifted lands to *nobles* who had supported, or promised to support them in times of war. As precious little new land was being created at this time (the Dutch only began reclaiming land that occasionally flooded in the 13<sup>th</sup> century), these gifted lands were usually newly seized as a result of military expansionism. Unsurprisingly, the more significant the service or potential service the noble offered, the better the lands bestowed upon them. These nobles then became tenants of the monarch or paid duties and taxes to the royal purse. In turn, the *peasants* (sometimes called serfs in Europe – encompassing slaves, villeins and freemen) who lived on the land were required to pay rent, tax, fees, or provide *service* to their noble *landlord* (that typically including fighting in his militia that gave him much of his power in the first place). The noble and militia then protected the local lands and the people on them from invaders, or they went to fight for the monarch on expeditionary campaigns further afield. The *villeins* were tied or bonded tenants, who rented small disparate parcels of land to farm themselves, across the manor or as part of a much larger field (the *open-field* system, the rules of which were overseen by the manorial court), and who existed socially in between slaves and freemen. The poorer peasants or slaves were given narrow strips of land on the noble's land for their own subsistence in return for their allegiance and work on his land. *Waste* land, at the fringes of the noble's land (such as clifftops and other areas of limited agricultural potential) was left for commoners or anyone else to cultivate, if they could. We will leave the rise of nobility and *how to be a noble* for another time. The system was administered under a variety arrangements, from slavery to land holding tenures from freehold title (*fee simple*) to arrangements such as socage (fixed payments, with no duties to the landlord), quit-rent (payments in lieu of service), leasehold (title with a rent commitment), and copyhold (literally a copy of the original title that was retained by the lord, given to a tenant in return for duties and service to his manor).

In England, the feudal approach is considered to have begun with the arrival of the Normans, although the Romans had initiated a similar *manorial system* in AD43, which had continued in degrees up until this time. Norman feudalism was

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introduced by William the Conqueror, following his defeat of the Anglo-Saxon King Harold at the Battle of Hastings in October 1066 (Harold had only succeeded Edward the Confessor on throne on 5 January). William quickly set about carving up his newly acquired lands, and shared them, as a reward and a means of control, between the 180 knights or barons loyal to him. Invasion and subjugation, it turns out, is something that has happened to most nations at some stage in their history, even Britannia – I wonder if there's the possibility of restitution from the Normans or the Romans before them.

The one major interruption to the feudal system was the signing of the Magna Carta (Great Charter) by King John in 1215 – a royal charter of rights aimed at making peace between the unpopular King and his rebel barons. Magna Carta was also a type of *human rights* act that affected the whole nation and reflected the Charter of Liberties of 1100, the laws introduced by Edward the Confessor, and the unwritten pre-Norman constitution). It was intended to protect church rights, give widespread access to impartial justice, and limit feudal payments to the Crown (which King John been forced to massively increase, to pay for his disastrous territorial wars with Philip II of France). Significantly, Magna Carta saw the restoration of ancient *common land* i.e. land under the control of the manor, but which was *waste* and available for *commoners* to farm as a source of wood, pannage and pasture (at one time almost half of the country was *common land*). Unfortunately, neither side upheld their commitments and it was annulled by Pope Innocent III, who had been invited to assist in reaching the settlement. Magna Carta was not properly enacted until 1297, when King Edward I reissued it and it passed into English law.

Otherwise, feudalism continued largely unchanged in England until the late Middle Ages, with the pandemic of its day, *The Black Death*, circa 1350. The death toll in England from the Black Death was around 40% of the population (in parts of Europe it reached 60%), and this catastrophic loss compounded the effects of a series of famines and fundamentally changed the structure of society. The very sudden contraction of the labour force available to work the land meant much manorial land went uncropped or harvested, and not enough peasants to tend to livestock. The shortage of labour shifted power from the nobles to agricultural workers, who were able to demand wages. As today, the scarcity of a resource (this time labour) increased its value, outside the prevailing system of government of the time (feudalism). These wages bought land and other benefits (it is generally considered the beginning of wider education and literacy amongst the populace – previously largely limited to nobles and the clergy). The whole situation was compounded by a series of particularly severe famines around the same period, which drove up the value of agricultural commodities. The result of this seismic societal shift was that feudalism was extensively replaced by a new agrarian capitalism, and unearned privilege was substituted for increased social mobility. Coincidentally, this socio-economic change occurred at around the same

time as a climatic one too, with the ending of the Medieval Warm Period and the beginning of the Little Ice Age (circa 1300 CE).

This relatively unfettered capitalism continued without too many exceptions until the 16<sup>th</sup> century, and the *enclosure* of *waste* land under the guise of *improving* agricultural efficiency, which was a euphemism for the reappropriation of common land. Enclosure, simply put, was the creation of *closes* – the encircling or fencing of smaller fields farmed by the lower classes, by partitioning larger, ancient open fields, thus denying access. Enclosure also took place when land owners coordinated their efforts to surround larger areas, sometimes entire parishes. Additionally, Acts of Parliament (particularly the *Act of Inclosure 1773*) compelled the surrender of land in return for sometimes substantial compensation – not everyone was against this part! To a degree, this was a return of feudal ways and the precursor to the Industrial Revolution, which saw the arrival and use of machinery and industrially produced chemicals that dramatically increased efficiency and reduced the need for manpower. This change in the supply and demand for labour tipped the balance back in favour of the landowners. The technological advancement created a surplus of workers and the now redundant farming hands became *vagabonds* and migrated to the cities in search of employment, which they found in the new factories – becoming what Karl Marx termed the proletariat. It is worth noting that Marx, while a staunch opponent of capitalism *per se*, considered that it had been fundamental to ending feudalism, and that it was the best economic system to facilitate the transition to a fully socialist state. Either way, both feudalism and socialism adopt zero-sum game attitude (someone has to lose in order for another to win) and are underpinned by entitlement: one wishes to inherit wealth, the other to take it, neither to earn it. It seems plain that only one system offers a win-win, i.e. a meritocracy that serves both the individual and society...good old-fashioned 14<sup>th</sup> century capitalism!

Balance in the supply and demand for workers maintains market equilibrium and ensures workers are paid in proportion to their effort. What is more, the impact of disruptive technological advances (like AI) are met in equal and opposite measure by new employment opportunities. Who knows, maybe the business idea that is bouncing around your head could become a source of jobs that will help offset the fast approaching step-change in our society.

It remains my opinion that the redistribution of capital on the basis of effort is wholly more equitable than that which is attempted through an opaque system of patronage, be that under feudal or socialist systems. Further, I suggest that overlaying uniform collectivist principles on top of the capitalist model breaks it and cannot work in the long run – doing so disrupts the essential role of demand-driven or realistic incentives. In support, I offer you the *cobra effect*, an example of which is called *perverse incentives*, this one from India in the late 19<sup>th</sup> century. Whilst under British rule, it was observed that poisonous snakes were attacking

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an alarming number of colonial subjects. The government, in its attempt to solve the problem, offered a bounty for every dead cobra presented to the authorities. Whilst initially highly successful, overtime individuals gamed the system and started breeding cobras to kill for the reward. When the programme was scrapped, the snakes no longer had any value and their owners released them into the wild, hugely increasing the natural population and making things much worse than before. This example of what is also known as Goodhart or Campbell's Law, has been seen in similar pest control scenarios across the world, including at Fort Benning (now Fort Moore) in Georgia, when hunters were offered \$40 for each pig tail handed in, as part of an effort to reduce the feral pig population. Not only did enterprising locals buy pig tails from nearby slaughter houses, but the wild pig fertility rate and survival rate of offspring increased dramatically, due to both the additional nutrition provided by hunters' bait and the preference for trophy males that left pregnant females to roam free. Perverse incentives exist in a plethora of other situations, too; for example, the construction of the US transcontinental railway in the 1860s. Congress had decided to pay the engineers on a piece rate for every mile of track built, and so the builders extended the amount of track by adding needless bends and detours. In a social context, we can see the same effect in play with the *welfare trap*, which can occur when unemployed people are disincentivised from joining the labour force: welfare dependents who are exempt from tax on their benefits are taxed on any income earned from low-paying or part-time work. Equally, if increased benefits are paid on a per dependent child basis (to cover the additional costs of parenting), the option for recipients becomes to either stay at home or pay for childcare so they can go to work.

I'll close this particular area with the wise words of Charlie Munger (the now deceased Vice Chairman of Berkshire Hathaway) '*Show me the incentives and I will show you the outcome*' i.e. incentives drive behaviours and if you think hard enough about it, it is possible to predict actions and the ultimate end game. This is obviously very important to you as you to assemble your thoughts surrounding your project – you must try to anticipate how your customers, competitors, legislators and other stakeholders will respond to the *incentives* you create or that are created by your offer.

### How Commercial Hospitality Real Estate Works

Hotel *brands* have increasingly adopted an asset-light model, meaning they own fewer of their hotels and instead manage other people's. They've even taken this to the next level, where they would much prefer to not manage hotels at all, but rather lend or franchise their brands to real estate owners, who employ third-party or *white-label* management companies to run their businesses for them. That said, there are real estate companies at work, who we still think of as being in hospitality. Despite selling more than 75 burgers every second, one particular US burger restaurant chain makes more money from real estate than it does from

food service. How does it do this? In the first instance it is through development. This particular chain, and other chains of fast-food outlets, have very strong balance sheets, meaning they have plenty of available cash to buy sites and develop them into restaurants. This access to capital also means they can often agree advantageous purchase terms when buying sites because the land owner knows they are a sure thing (why risk holding out for a higher price from a less solid buyer when you can do a deal at a slightly lower price with a buyer you know has the money to complete the transaction?). They also operate at such a scale that they can build very efficiently from both a cost and speed perspective, as well as having a highly standardised model that affords a known level of quality. Small town government knows what these chains add to the local infrastructure and the jobs they create and will generally be minded to cooperate, granting permission or making land available. So how does it work?

- i) The Giant Burger Co or GBCo. (although it could just as easily be chicken or tacos), buys a site outside of town near a major highway, for say \$250,000 dollars.
- ii) GBCo then spends \$750,000 to build the restaurant, therefore total cost to GBCo is \$1million.
- iii) GBCo then rents the restaurant to a franchisee, Mrs B, who agrees to pay say \$100,000 per year to rent the site. As a trading franchise restaurant, it is highly unlikely that the restaurant will fail and not be able to pay its rent, particularly with such a big brand name above the door.
- iv) This sureness of income means that a real estate investor Mr A. will want to buy the restaurant with Mrs B tenant in place, from GBCo, as part of Mr A's larger real estate portfolio. For the sake of argument, let's say that Mr A expects a 5% return on his investments in fast-food restaurant businesses.
- v) Mrs B has already signed up to pay rent at \$100,000 per annum. So if \$100,000 represents a 5% return, 100% would be \$2,000,000 (if you're not sure of this check on your calculator,  $100,000 \div 2,000,000 = 0.05$  which is 5%). For the mathematically-minded, 20 is the reciprocal of 5% i.e.  $5\% = \frac{5}{100} = \frac{1}{20}$  (that's what the % sign means) and therefore 5 goes into 100, 20 times ( $5 \times 20 = 100$ ). So the computation becomes simple,  $\$100,000 \times 20 = \$2,000,000$  (alternatively divide 100,000 by 0.05, which give the same answer on your calculator).
- vi) So, Mr A, accepting a 5% return on his investment is prepared to pay \$2million for the site, including the GBCo branded restaurant on it.
- vii) GBCo has made a tidy \$1,000,000 on the development, which is 100% profit on cost, which will probably take less than 2 years to achieve. Even if they don't sell the site to Mr A and they decide to keep it in their own portfolio, they can borrow against the new increased value of the rental income to buy and develop more sites under the GBCo branding, which equals more outlets for them to supply and potentially more rental incomes.

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The story doesn't end there, either. In addition to the development profit, GBCo retains an ongoing interest in the business through the franchise arrangement. In addition to buying opening stock and holding working capital to pay wages, rent etc. (which can be anything upwards from \$400,000), a franchisee might be required to pay for the fitout of the restaurant i.e. for furniture and equipment, as well as some external branding, etc. (\$1m to +\$2million, depending on location and size of restaurant). On top of this, Mrs B might have to pay an initial fee (this is normally paid to GBCo for *technical services* support, which is basically to use their specification and designs during pre-opening) and can be anything up from \$100,000. Under the franchise agreement, Mrs B will then also be liable for a number of annual fees:

- i) Rent, typically +/-10% of turnover or total revenue,
- ii) Royalty or licencing fee: 4% of revenue,
- iii) TechOps Fees (for computer software and support, use of a corporate email address, etc.), which can be anything upwards from \$10,000 per year (this is in addition to transaction fees charged by credit/debit card companies like VISA, Mastercard and American Express etc.).

Before you shout *foul play*, bear in mind that these fees are for the opportunity to operate a business that will generate the franchisee's business millions of dollars of revenue each year, through a tried and tested model that supports 100% and doesn't often fail. It's just a cost of doing business...and a barrier to entry to chancers. In my general observation across businesses, franchise fees and set-up costs are worked in such a way that if you only push the business to be average, it will operate at, or near to, break-even. If you want to make a good living, you'll need to work it harder and be more successful as a franchisee – the franchisor (GBCo) wants to know that you're fully committed to it, after all, it's their name on the line.

That said, our real world and unnamed burger chain takes around two-thirds of its revenue from the 5% of outlets it actually owns, with the remaining third earned from the 95% of outlets it franchises to the Mrs Bs of this world. However, and this is where it is truly enlightening, owned stores only convert around 15–18% of revenue to profit, while franchises convert the chains' revenue to profit at a rate of 80–85%. This means that franchisees that buy stock from, and pay rent and franchise fees to the group, generate around three times as much of their total profit. This is why the company has built a supply chain to sell burgers to the franchisee at \$0.15 each, which they will in turn sell to the customer for \$4–5 – so that they can be sure they'll get their rent and franchise fees paid.

Similarly, when I consulted at a restaurant in the Lake District, I had the challenge of helping the building owner understand that it was in his interest to support his tenant (the chef) who ran the business that operated in his building.

Here's how it worked:

- The owner had invested time and money (£525,000) into buying and refurbishing the building and had set the rent the chef should pay to £3,500 per month.
- The lease was written for 10 years and rent was fixed for the first five years and then subject to an *upwards only* review (i.e. when the time comes to set the rent for the subsequent five years, contractually it cannot be set for less than the amount of the first five years – this is to allow for inflation and the reducing value of money over time, thereby helping to protect the value of the owner's investment in the bricks and mortar).
- The building owner thinks, my monthly rent of £3,500 (or £42,000 per year), would be valued on a multiple of 12.5 times the annual rent i.e. £42,000 x 12.5 = £525,000. In real estate terms, the capital value of £42,000 represents an 8% yield (or return) on £525,000 (try it yourself by dividing £42,000 by £525,000). At this point, the value equals the expenditure the building owner has made on the property, which is probably okay (at the time of writing and in the UK, you wouldn't expect to get more than a 5% return on your savings at the bank).
- The building owner had set everything up so that the lease was FRI or *fully repairing and insuring* (i.e. all maintenance and insurance costs were the responsibility of the chef/operator) and therefore he had relatively few ongoing costs until the end of the tenancy (when he may decide to conduct another thorough refurbishment to help maintain the value of his investment).
- The chef meanwhile was thinking purely in terms of the operating business and his commitment to pay £3,500 per month in rent, aside from all the other costs of the business.
- The chef's business model looked like this:
  - **Turnover** or revenue = £1,000 per day, Sunday to Thursday + £1,500 per day on Friday and Saturday gives a total of £8,000 per week or £34,666 per month (£8,000 x 52 weeks = £416,000 divided by 12 months).
  - **Variable costs** of the business = £23,500 per month (cost of sales/raw materials = £9,700 per month, direct expenses £1,700 per month, while payroll/staff costs, including chef's basic salary = £12,100).
  - **Overhead costs** = £6,500 per month (administration, marketing, maintenance, insurance, heat, light, and power costs etc.).
  - **Total operating costs** = £30,000 per month.
  - **Net Profit** therefore = **Revenue** (£34,667) less **Operating Costs** (£30,000) = £4,666, less **Rent** of £3,500 = £1,167 per month (or £14,000 per year).

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- Profit to Rent Coverage (i.e. how many times does the profit cover the rent) is £4,666 divided by £3,500 = **1.3 times** coverage, which is not very much coverage (by way of a comparison, a bank will typically require debt service coverage on a loan of 1.8 times as a minimum). Therefore, it might seem likely to a valuer that there would be a higher chance of default on the rent (the business would only need to see a 3.5% or £280 per week reduction in revenue, for it to be unable to pay the rent in full). It is therefore a riskier investment for the building owner. As a consequence, instead of valuing the building at 12.5 times the annual rent, the valuer might say that it is only worth 10 times the annual rent. The building is suddenly therefore only worth £420,000 (or £105,000 less than the original investment), just because the tenant is less reliable.

To emphasise the importance of the quality of the rental income (and the reliability of the tenant), consider that if the business turned over just an additional £47 per day during the week and £71 per day at the weekends (total increase of just 4.7%), it would increase rental coverage to 1.8 times (profit before rent would be £6,300 compared to £4,667 at 1.3 times). Rent coverage at 1.8 times would in all likelihood mean a valuer would consider it less risky and apply a 12.5 times multiple to the annual rent (£42,000), making it worth £525,000. If the chef could drive revenue and increase it by 10% more than the original scenario of £8,000 per week to £8,800, it would give a rent service coverage of 2.32 times...which would be less risky still and maybe worth 14.3 times the annual rent of £42,000 = £600,000. Giving the building owner an on-paper profit of £75,000 on his original investment. If the chef were part of a much larger organisation that made large profits and guaranteed the rent, it would also have a profound and positive impact on the valuation multiple applied to the rent. This is known as *covenant* strength (or covenant for short), and the better the covenant, the higher the multiple and higher the value of the rent that the business pays to the building's owner. This is why you will see bigger, more financially stable companies winning bidding wars to take the lease on a building and operate a business there – not because they necessarily have better acumen, but because they can cover the rent and therefore make it more reliable. Sometimes this is referred to as improving the quality of your cash flow.

- Turning the telescope around and looking at the chef's situation, the annual value of *his* cash flow (we're calling it net profit for now) might normally be worth a multiple of 6. So taking his net profit after rent of £14,000 x 6, from the original scenario, it would value his business at £84,000. If the chef can increase revenue to the £8,800 per week, and therefore increase his annual profit to £55,600, his business would suddenly be worth £333,600. The multiplier of x6 applied to the net profit is lower than the multiplier of x12.5 for the building owner, for two reasons: 1) The chef doesn't own the underlying

asset, which is worth considerably more than his lease, and 2) he has the liability of paying the rent whether the business can afford it or not. This, as well as all operating costs of the business, which must be paid along with the rent before taking any profit (or paying to cover any loss).

The following simplified spreadsheet illustrates what we've been looking at (read it from the top, step-by-step downwards):

|                               | <u>Per Month</u> |                  | <u>Per Year</u> |                                |
|-------------------------------|------------------|------------------|-----------------|--------------------------------|
| <b>Revenue</b>                | £                | <b>34,667</b>    | £               | 416,000                        |
| <i>Less</i>                   |                  |                  |                 |                                |
| Cost of Sales                 | £                | 9,700            | £               | 116,400                        |
| Direct Expenses               | £                | 1,700            | £               | 20,400                         |
| Payroll                       | £                | 12,100           | £               | 145,200                        |
| <b>Variable Costs</b>         | £                | <b>23,500</b>    | £               | <b>282,000</b>                 |
| <br><b>Overheads</b>          | £                | <br><b>6,500</b> | £               | <br><b>78,000</b>              |
| <i>subtotal</i>               | £                | <b>30,000</b>    | £               | <b>360,000</b>                 |
| <br><b>Gross Profit</b>       | £                | <br><b>4,667</b> | £               | <br><b>56,000</b>              |
| <i>less</i>                   |                  |                  |                 |                                |
| Rent                          | £                | 3,500            | £               | <b>42,000</b>                  |
| <b>NOP</b>                    | £                | <b>1,167</b>     | £               | <b>14,000</b>                  |
| <br><i>Rent</i>               |                  |                  |                 |                                |
| <i>Multiple on rent</i>       | <b>12.5</b>      |                  | £               | <b>525,000</b>                 |
|                               |                  |                  |                 | <i>(building value)</i>        |
| <i>Yield (on rent)</i>        | 8%               |                  | £               | 42,000                         |
| <i>(return on investment)</i> |                  |                  |                 |                                |
|                               |                  |                  |                 | <i>Profit to Rent Coverage</i> |
|                               |                  |                  |                 | 1.33                           |
|                               |                  |                  |                 | $(£4,667 \div £3,500)$         |

**Figure 3.4** illustrates how the reciprocal of the exit yield gives a multiple of earning that is applied to net operating profit (NOP) to give an exit valuation

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These are real-world examples of quite how significant the real estate part of any hospitality business is, regardless of whether you own the building you're operating the business from or not. Know that if you're doing well and you don't own your premises, you'll be adding value to your business, just not as fast as you're adding value to the underlying real estate.

Brands invest heavily in their development in an effort to differentiate and garner loyalty – individuals employed within the business should appreciate how difficult, expensive and time-consuming it is to create a brand and how lonely it can be when you're on your own outside in the world as a new small business.

### The Laws and Licences

#### Contracts

At the end of the day, a franchise, MA, lease agreement, a licence, or indeed the purchase of land essentially boils down to a contract – a legally binding agreement between two parties. As with all formal legal agreements, and even some seemingly informal arrangements (where a legal contract may be deemed to have been created or exist), it is essential to seek professional advice before entering into any treaty of material value or obligation. In the case of simple agreements, you may sometimes be able to use your common sense to get the gist of the detail, provided you have enough time to methodically go through and research the meaning of specific terms or clauses. However, note that contracts (including lease agreements) are often loaded with technical and/or legal language that will take an inordinate amount of time to distil meaning from. This is unlikely to be time you can spare, and even if you do have enough time, you still may not get to the bottom of it without expert input. Contracts are there to protect all parties, and make clear to all parties how an arrangement is to be executed, but they can easily store up trouble for the future, if you don't know what you're doing.

Having already waded through the nature of different forms of title, occupation and operation of buildings, now is the perfect moment to have a quick look at precisely what a contract is. In essence, it's the legally binding agreement that is formed when written, and is comprised of 6 component parts:

- i) **Offer** – one party wants something from the other, and the other has the capacity to fulfil the want, for an exchange of value (which is normally monetary, but can be an action or outcome). From the want comes the *Offer*, and from the ability to realise it comes the responsibility of doing so (in return for the exchange of value) e.g. I want to rent your bar for \$2,000 per month rent. The offer must then be received by the other party (offeree) before it

formally exists. It is possible for the offeror to amend, withdraw or terminate the offer at any point until it is *accepted*.

- ii) **Acceptance** – once received, the offeree can decide whether to accept or reject the offer (a *counter offer* is considered a rejection and the process begins again). An offer is officially deemed to have been accepted once it has been signed. However, the law can become a little vague and on occasion acceptance has been considered to have been made verbally, by actions of the offeree, subject to conditions or through an option – a promise which meets the requirements for the formation of a contract and limits the promisor's power to revoke an offer (i.e. which grants the offeree the right to buy an asset at a specific price at a certain point in time or the offeror the right to sell an asset at a specific price at a certain time in the future). An acceptance must be explicit (in a case in the UK, the seller of a horse stated that if he didn't hear to the contrary, he would assume the offer was accepted and the horse to be sold – this was rejected by the court). Additionally, both parties must act and if the actions are explicit, then acceptance is likely to have been achieved. Further, a letter accepting an offer is considered to have been enacted once it has been posted in the mail system.
- iii) **Awareness** – as the title suggests, both parties must be aware they are actively entering into an agreement and freely agree to be bound by its obligations, in what is termed *a meeting of the minds*. If these considerations are not fulfilled, the contract might be invalidated and therefore not binding. Awareness extends to cover situations where an agreement is made when one party is deemed to agree under duress or undue influence, fraud, or misrepresentation. For example, if you rush the other party to sign an agreement quickly before they have had time to consider its implications or before they have received proper legal advice, it might be suggested they have not acted with free will (or what the health care and media sectors might call informed consent). In other words, all parties must demonstrate they know what they're getting into – the agreement must be *genuine* and *mutual* with all parties consenting to be bound by its terms.
- iv) **Consideration** – is an essential component for a contract to be enforceable and valid. The agreed *want* or *desire* of one party must be fulfilled by the other in exchange for something of value (as per the *Offer* above). If you give something away for free, there is no *consideration*, because there is nothing expected in return. Consideration can either take one of two forms: **Executed Consideration**, when something *has* taken place, i.e. you've agreed on the price you'll pay for something (e.g. when you make payment for a dress you buy online). **Executory Consideration**, when something *will* take place (e.g. a seamstress agrees to adjust the dress to fit better for an estimated price that is payable upon completion). Either way, consideration must be an

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exchange of value, but as the dress example illustrates (either buying it or promising to adjust it), it doesn't have to be monetary, it can be in the form of property, goods, services, or even promises to do something (e.g. protection from harm). Consideration does not have to be equal on both sides, it just has to be *sufficient* i.e. something of value that is mutually agreed on.

- v) **Capacity** – refers to someone's ability to understand and therefore legally enter into a contract. In the simplest terms, capacity implies all parties must fully understand the words and meaning of the contract. For someone to have capacity, they must be able to demonstrate they are legally permitted to enter into the contract (i.e. they are not a minor/are of legal age) and that they clearly understand the obligations, terms, and consequences of the contract before they sign it (i.e. they cannot be a person with a brain disorder such as dementia, under the influence of drugs/alcohol, or someone who doesn't have sufficient understanding of the language used). Where someone falls into one of these categories, but it would be in their best interests for them to be party to the contract, a representative may be appointed by the courts, or a translation might be provided (in the case of foreign languages).
- vi) **Legality** – All contracts are subject to the laws of the jurisdiction in which they are agreed, whether that is international, national or local law. Where laws are apparently in conflict, it is generally the senior law, as determined by the courts, that takes precedence. This is true even if parties were not initially aware of the law – a lack of awareness of the relevant legislation is insufficient to escape the burden of the applicable law(s). Of course, a contract to conduct an illegal activity (such as committing a killing or a theft) is not valid or enforceable, even if you wanted to take someone to court for breach (i.e. breaking or failing to observe the agreement). While there may be nuance behind specific laws in certain jurisdictions, there are a number of more commonly accepted situations where a contract is no longer legal:
  - a. **Force majeure** i.e. when it is impossible to fulfil the obligations of the contract due to circumstances beyond the control of the parties.
  - b. **Mistake**, where an error in the contract has a *material effect* upon the obligations and responsibilities initially agreed to.
  - c. **Public policy and illegality**, or a situation where a contract violates public policy or puts the public welfare at risk.
  - d. **Unconscionability**, occurs when the contractual obligations *shock the conscience of the court*, meaning the obligations are so oppressive that no reasonable or informed person would otherwise agree to it.
  - e. **Undue Influence, Duress, Misrepresentation**, which simply means if any party enters into an agreement as a result of coercion, false statements, improper persuasion or threats.

It is important to be aware of the following when entering into a contract, for it to be enforceable: all parties must intend for it to be legally binding; it must be possible to perform the obligations of the contract, the terms of which must be clear and specific so they are understood by all parties; any contract-specific legalities are adhered to (e.g. some contracts *must* be in writing); any contractual timeframes must be understood and adhered to; parties are required to fulfil the contract obligations and once all obligations have been fulfilled, the contract ends or is discharged. If parties fail to fulfil their obligations under the contract, the other party may be entitled to legal remedies (what we might recognise as damages or specific performance i.e. where the party in breach is forced to fulfil a requirement by court order or injunction).

### Negligence

The other significant thing about contracts that the budding maître d' (or maître d'hôtel, meaning *master of the house*) should be aware of, is that obligations or responsibilities towards an individual and/or the public still exist, even if no contract is in place. Before I attempt to explain this seeming contradiction, it is important to identify the basis of the rule of law in your jurisdiction.

The law in the US operates under a mixed system (derived from constitutional law, statutory law, treaties, administrative regulations, and the common law). In the US, the Constitution is the basis upon which all else hangs, and prescribes the foundation and the boundaries of the federal government, as well as various civil liberties. Federal and local government then write and enact laws within this constitutional framework. The US system, as with all others, is the result of history and so shares similarities with the British, European (with significant elements of Roman law and particularly French law, stemming from the Napoleonic Code) and Scottish systems.

In England and Wales, there is a constitution, but it has never been codified (it is not a single, written document as you would find in the US and elsewhere) and instead is largely derived from a variety of statutes, conventions, judicial decisions, and treaties, under the *Common Law* system. Scotland, despite sharing the same monarchy, is different, and takes its law from: legislation, legal precedent, specific academic writings, and customs, some of which date back to Roman law – primarily concerned with The Law of Persons, The Law of Things and the Law of Actions). Incidentally, under Roman Law, there were no trademarks and other forms of intellectual property; designation was limited to ‘marks’, which often related to a geographical area and were the precursor to the modern Protected Designation of Origin (PDO). Under a PDO, an item takes protection from, and is known for, its quality or characteristics relating to the region’s natural and human factors (or *terroir*, think Champagne) rather than say, a trademark being held by an individual or company. Nations that

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are former colonies (whether British, Dutch, French, Portuguese, or one of the many others) tend to follow the legal system of the colonisers with local variations. Australia and New Zealand both operate common law legal systems, but have written constitutions as well (they are constitutional monarchies). Nigeria and other African nations operate mixed systems that take influence from the English Common Law, as well as from Customary law, Islamic (or Sharia) law, its Constitution and other enactments passed by the National Assembly. While in Côte d'Ivoire, the legal system is based on the French civil code. European countries (excluding the UK, Ireland and Scandinavia) generally operate on the basis of *Civil Law* (aka continental law or Romano-Germanic law) – a collection of laws that cover private law under the Civil Code (themselves being a series of treaties, regulations, directives, decisions, recommendations and opinions voted on by the respective governments). Civil law originated in continental Europe in the Middle Ages and is based on Roman law, national legislation, and custom.

*Common Law* originated in England in the same period, also known as the doctrine of precedent (or *stare decisis*) and is still in operation in England, Wales and Northern Ireland. Under the Common Law system, a court interprets the law and makes a ruling on a case based on this interpretation. This ruling itself then becomes the law...until it is challenged and replaced, in a court of higher standing (usually at appeal) by a new ruling. This allows the law to adapt, grow and change to cope with the prevailing societal conditions and challenges. The specific *case* becomes the relevant *law (case law)* in all subsequent cases and the more junior courts (or those of equal standing) are bound by its judgements until it is replaced or updated.

Under the system, the *ruling* applies to the processes to be followed and the relevant law, facts, and comparable cases to be considered by the court when presiding over similar cases. For interest, the more junior courts in England, Wales and Northern Ireland are the Magistrates Courts or Tribunals, with Crown and County Courts above them, and so on, right up to the Supreme Court of the United Kingdom, which is the highest court in the land (previously this was the House of Lords). What the common law system means in practice, is that the barristers (lawyers who appear in court) present the evidence of the case, as well as citing the judgements and verdicts of similar preceding cases, as ruled by the previous courts. Every new case that is heard in court requires interpretation of the law, and from that interpretation comes a new ruling that sets a new precedent that will hold until it is challenged. The advantage of the common law approach, unlike statute law (that can only be voted on and changed by government law makers) is that the interpretations are made in the context of the time in which they are made and so the law automatically adapts to the time, and in theory at least, remains relevant and up to date.

Under most systems, particularly those with roots in medieval England, the law can be roughly divided into Public Law and Private Law (although no strict delineation exists). Private law (or civil law) covers the disputes between private individuals, parties or entities such as companies (it therefore includes commercial law, competition law, contract law, corporation law, family law, labour law, law of tort, property and trust law). Public law, by contrast, is concerned with the relationships between private individuals or organisations and the state or public bodies, such as local authorities (this includes: administrative law, constitutional law, criminal law, international law and municipal law). Private law can for simplicity be broadly subdivided into laws regarding property and those covering obligations, the latter relating to contracts, torts (non-criminal wrongdoings) and restitution. Having already covered the basis of contracts, we will look at tort and restitution now.

To quickly cover off *restitution*, unlike cases of contract or tort that seek to compensate the claimant with damages in relation to the harm they have suffered, the focus in restitution is upon correcting the unjust enrichment of the defendant.

A crime is a criminal wrongdoing that is generally punishable by the state. This is in contrast to a *tort*, which is a civil wrongdoing that causes one party to suffer loss or harm as a result of the actions of another (or their failure to act). This implies a legal liability for the party who commits a *tortious act*. In practice, the difference between crimes and torts is that criminal law aims to punish wrongdoers, while tort law aims to compensate the party who has suffered harm or loss as a result of the actions of the other, or more specifically, to provide redress and relief from the wrongful acts of others. As you will no doubt have seen on the news, and depending on the jurisdiction, some wrongful doings can result in both a civil case and a criminal prosecution. Obligations in tort (and criminal) law are more fundamental than in contract law and are imposed regardless of whether or not the parties have a contract i.e. individuals and businesses may be deemed to have a duty of care to the public at large.

Both breach of contract and tort wrongdoings are generally covered under civil law, meaning they are pursued by private claimant(s) for damages or restitution (unless they involve criminality, in which case they are prosecuted by the state as crimes with possible prison sentences). Obligations exist in both cases. The single largest area of tort law is *negligence* and in our increasingly litigious, compensation-oriented culture, it's important that you are aware of it.

In cases of negligence, it must be shown that the defendant owed the claimant a duty of care (as established in the case of *Donoghue v Stevenson*, when the House of Lords adopted the notion of a general duty to '...take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to

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injure your neighbour...', which has been updated by the case of *Caparo v Dickman*). A duty of care exists if the claimant can show that the damage they have suffered was foreseeable; that there was proximity between themselves and the defendant; and that in all the circumstances, it would be fair, just and reasonable to impose liability on the defendant. Having demonstrated that the defendant owed a duty of care, the claimant must prove that the defendant was at fault (i.e. in breach of the duty of care), which is done in two stages:

- i) The court determines the *standard of care* that the defendant owed the claimant (the standard a 'reasonable person' would expect in the relevant profession, occupation or activity). The standard is objective, and will likely weigh the degree of foreseeability or risk of harm against the cost of avoiding the harm, and the benefits to society foregone if the activity in question is not carried out. In cases of professional negligence, the standard is of a *reasonably competent person* in the said profession, which means in practice that the court is likely to defer to the standards set by the relevant professional body. This element is a matter of *law*.
- ii) Once the *standard* has been established, the court, as a matter of *fact*, must determine whether the defendant's actions met the required standard.

Then, the claimant must demonstrate cause – that the defendant's breach of duty (under the standard established above) *caused* the harm to them, using the 'but for' test – *but for the tort*, would the claimant have suffered the damage? In other words, *were it not for the wrongdoing, would the person have suffered harm or loss?* When the answer is *no*, causation is established (and where it is *yes*, the defendant is not liable, even if they acted negligently i.e. the harm/loss was not *caused* by the defendant but by other actors or circumstances).

Having established cause, the claimant must show the damage could have been *reasonably foreseen* and that it was not *too remote* from the defendant's negligence. In practice this means, was there a gap between the defendant's act and the harm suffered by the claimant (e.g. the court finds in fact that the act of a third party or the defendant themselves caused the harm).

The last step is to prove that the damage or loss suffered is the type of damage or loss that can be recovered under the law of negligence. This can be quite complicated, but in essence means that if, as in the case of *Greg vs Scott*, the claimant's damage was to lose the *chance* of avoiding injury (a GP failed to diagnose a terminal disease, which thereby reduced the *chance* of survival for 5 years from 42% to 25% once it was diagnosed). In this case, the House of Lords determined that the claimant had not suffered a compensatable injury and therefore the loss was not compensatable.

Should all of the foregoing conditions be fulfilled, the claimant will be entitled to compensation – or as far as is possible, they shall be returned to the position they were in before the wrongdoing occurred. Compensation typically falls into two categories, *pecuniary* i.e. to compensate for financial loss, as assessed at the date of the trial (loss of earning, medical bills or damage to property, etc.), and *non-pecuniary*, to cover loss of amenity (e.g. harm in the form of pain or suffering). Compensation cannot be reassessed at a later date and can only consider the damage or loss actually suffered. It is also worth noting that in negligence cases in the UK, there is no jury and it is the judge alone who hears the case and awards compensation.

Where it is demonstrated that the defendant acted negligently, the defence will try to avoid liability altogether, by showing that the claimant consented to the specific risk of injury or loss, or partially, by showing that the claimant was also negligent and therefore partly responsible, too. In the latter case, the court apportions blame between the parties and reduces compensation to the claimant accordingly. Occasionally, a defence may try to prove the claimant was acting illegally at the time of the damage or loss. However, it is important to be aware that because of the harshness to the claimant, this defence does not often succeed.

Negligence law goes on to cover the specifics of public bodies, which do not have immunity and can be pursued by private individuals. In addition, public bodies may have statutory duties or responsibilities. Then there is the tort of *misfeasance in a public office* when ‘an official knowingly acts in excess of his powers or acts with malice towards the plaintiff’, in which case it is considered to be aggravated damage and punitive damages may apply. There may also be claims against public bodies involving breaches of the rules under The European Convention of Human Rights, especially under section 8 of the Human Rights Act 1998.

### ***Employer’s Liability***

Another important part of the law you will need to understand is employer’s liability, and you will quickly see the importance of carrying insurance to cover the activities of your business in relation to this. In fact, in the UK, insurance is compulsory and failure to insure is a criminal offense. While the rules vary between jurisdictions, employer’s liability (or the equivalent in your own country) tends to be stricter than negligence and falls into two categories: liability towards employees and liability for the acts of employees towards third parties. Importantly, liability may still exist even when the fault of the employer may be absent. It is not useful for me to go into great detail on the specifics of employer’s liability, employment, consumer or other laws, but I do strongly encourage you to get up to

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speed with your responsibilities in the jurisdiction in which you intend to operate or develop your business.

Other laws and their equivalents to bear in mind include:

### ***Product Liability***

Historically, product liability was purely covered by contract law (generally between the buyer and the producer) and/or tort law. These days, consumer protection legislation has overtaken much of this. Also worth mentioning here is that most purchases have what is referred to as a *cooling-off* period – a period of time after purchase, during which a customer can cancel said purchase, and return it, for whatever reason, and obtain a full refund. Different countries have different rules for the duration of *cooling-off* periods and these can also vary when it comes to different purchases. In the UK, this is 14 days and applies to all contracts ‘concluded at a distance’ by a consumer (this is broadly the same across the EU). Meanwhile in the USA, the federal government mandates a 72-hour cooling-off period for many consumer transactions completed on a similar basis (i.e. at home or away from the seller’s traditional place of business). Individual states may mandate for variations of this law and provide specific extensions to cover purchases such as insurance, health club memberships, time-share properties or product warranties. This legislation is unlikely to impact food sales in a restaurant setting, which is generally covered by exclusions, exemptions or other regulations and law (see below). As an example, the following is a list of exclusions and exceptions in the UK (note: there is no cooling-off period for services arranged with a company in-store or on its premises):

- Alcoholic beverages (with certain caveats);
- Auction sales;
- Booking a hotel room or rental of accommodation for residential purposes;
- Catering or leisure activities for specific dates (e.g. hotel, restaurant and wedding/event bookings, or theatre tickets);
- Construction of new buildings (including materially new buildings by the conversion of existing ones);
- Gambling (as per the Gambling Act 2005 and includes gaming, betting and participating in a lottery);
- Goods that after delivery become inseparably mixed with other goods;
- Goods that are sealed where unsealing could give rise to health and safety issues;
- Goods where the price may fluctuate during the cancellation period;

- Houses (see the exception regarding the creation of immovable property or rights therein);
- Items that deteriorate quickly (e.g. flowers or vegetables);
- Medications (prescription) and medical supplies;
- Milkman exception: foodstuffs and beverages for current consumption which a trader supplies on frequent and regular rounds to the consumer's home;
- Package travel (including holidays and tours);
- Passenger transport services (e.g. airline/train tickets);
- Personalised goods, or customised goods;
- Sealed CDs, DVDs, or software products, when the seal or wrapping is broken;
- Service contracts with a specific date for their performance, relating to the supply of accommodation, transport of goods, vehicle rentals, and catering or leisure related services;
- Specific financial products and services (services of a banking, credit, insurance, personal pension, investment or payment nature);
- The creation of immovable property or rights therein (i.e. buying or investing in property);
- Timeshare, long-term holiday product, resale and exchange contracts.
- Transactions concluded: by means of automatic vending machines or commercial premises; with an operator through a public phone for the use of the phone or for the use of one single connection, by telephone, internet or fax, established by a consumer; and by way of execution or by authority of law;
- Transporting goods, including courier services;
- Urgent repairs and maintenance;
- Vehicle rentals.

While much of the foregoing legislation is specific to the UK, it is mirrored in Europe, the US and elsewhere in the world, too. Importantly for the hospitality professional, you have a duty of care to your customers and employees and there are multiple case laws that establish the precedent. Additionally, common law determines that there is an increased burden of care when dealing with the public in the context of an environment where it might reasonably be expected that they could be intoxicated through alcohol or have diminished capacity to look after themselves (or make decisions) in general. Adequate signage, lighting and other protections must be in place to prevent customers and employees alike from injuring

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themselves. Further, any sign in the car park (parking lot) or at the coat-check that warns guests that the business accepts no liability for personal belongings, vehicles and/or their contents left unattended, or that they are left at the owner's risk, will in all likelihood be useless as a defence against a claim of negligence or vicarious liability by itself (unless supported by evidence of procedures and practices that were in operation that illustrate that the business had done everything reasonable to prevent harm). This is particularly so if the claimant can demonstrate that staff did not adequately fulfil their duty of care or that inadequate measures had been taken to prevent likely harm to customers or their possessions.

### Other Laws and Licences

Similarly, other legislation governing the hospitality industry may vary between countries, but the principles are broadly similar and it is important to make yourself aware of the rules applying to the industry you're getting into – I am not aware of any jurisdiction in the world where ignorance of the law is a viable defence! The following are legal areas you should consider. While focused on the UK, similar laws apply elsewhere. I repeat, for your own sake, make sure you're up to speed in your jurisdiction:

#### ALCOHOL AND LICENSING:

You must obtain a licence if you wish to sell alcohol at your business in the UK, whether that is for consumption on or off the premises. The law differs between England & Wales, Scotland, and Northern Ireland, as well as being different across Europe and the United States. The 21<sup>st</sup> Amendment to the US Constitution grants each state the power to regulate the sale of intoxicating liquors within their jurisdiction, plus there is the National Minimum Drinking Age Act 1984 (which requires all states to set their minimum age to purchase or possess alcohol to no lower than 21 years of age, or forfeit 8% of their federal highways funding). As said elsewhere, it is essential to secure the necessary licences and/or permits before you start your business. In England & Wales, the sale of alcohol to the public is governed by the Licencing Act 2003, which regulates licensable activities, being the sale of alcohol, provision of regulated entertainment and late night refreshment. In this jurisdiction, it is necessary to have either a *premises licence/club certificate* (i.e. the physical space where the activity is carried out) or a *temporary event notice*.

This licence is issued by the licencing authority (usually the local council), with the express remit of promoting the licencing objectives, which are: the prevention of crime and disorder; public safety; the prevention of public nuisance; and the protection of children from harm. In addition, each premises must have a *designated premises supervisor* (DPS), who is registered on the licence as the premises supervisor. The DPS must hold a personal licence (the licence to sell alcohol),

which requires, amongst other things for the holder to be an appropriate person (over 18, a UK resident and entitled to work in the UK, possesses an accredited licencing qualification, not convicted of any relevant offence,), paying the necessary fee and registering with the licencing authority. Similar systems are in operation across the globe and are enforced with varying degrees of vigour by the relevant authorities. Most of the information for which you need to submit an application for a premises licence can be found on the relevant local authority website and you may wish to seek the help of a lawyer to help walk you through the process (although of course this will come at a cost and the only alternative is to get fully educated yourself either through self-guided study or a certified course, which will on occasion be mandatory). Most applications to conduct any business will require you to complete and submit details of your operation, such as:

A plan of the premises to which the application relates, who is going to be running the business, and an *operating schedule* covering:

- 1 the proposed relevant licensed/regulated activities,
- 2 the times of operation is open to customers,
- 3 when the application is to run from and to,
- 4 where the application is to be applied and details of who is going to be the prescribed individual who the application relates to,
- 5 whether the application relates to sales for consumption on and/or off the premises (in the case of alcohol),
- 6 what steps are you going to take to make sure you, your staff and customers are safe.

As a business owner, you might have to consult with your neighbours and other local businesses who might be affected by your operation, as well as the local authority (possibly including police, fire/rescue, and health and safety bodies) who will issue permits or licences for you (and police your adherence to any restrictions they may impose). There will likely be specific requirements relating to any exhibition of films or shows, as well as in the instance where door security is required or in operation. In the UK there are also additional restrictions on the nature of promotions you might want to run if they relate to: selling alcohol at very low prices, encouraging people to drink quickly, or to drink more than they otherwise would (e.g. free pouring alcohol into customers' mouths, known as a 'dentist's chair', is now banned). Also, establishments selling alcohol may be required to supply free tap water to customers, have an age-verification policy in place, and sell alcohol in small measures in addition to the normal measures. In the UK, failure to perform some of these tasks can be an offence, punishable with a fine, up to 6 months in prison or both). Elsewhere, regulations can be even

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more onerous and ultimately in some instances you might have your business closed down, so it is really important to stay on the right side of the law.

**Premises regulations – Other laws might revolve around:**

- o The provision of **live music** (this can change in some instances depending on whether the music is amplified or not).
- o **Piped music** will likely involve playing recordings of copyrighted music (including incidental or background music or music on TVs and radios, or performed live), and so you will probably need *The Music Licence from PPL PRS Ltd* (the Performing Rights Society) or equivalent.
- o If you offer short-stay, overnight accommodation with TVs in the rooms, you might need a '**Hotel and Mobile Units Television Licence**'. Similarly, if you have a DVD library, you need a concierge licence, while you'll need a hotel vision licence for in-room entertainment, a Motion Picture Licensing Company (MPLC) licence to show films or TV shows, and if you want to use images on your website or in your marketing materials you must have permission from the copyright owner. Note that even if you do a meta search for images for your website using the words 'copyright free', this does not necessarily mean you have permission from the copyright holder. I have done this once myself, innocently, but to my cost – being pursued by an online image catalogue company (using software that trawls the internet 24–7 to see if their images are being used without permission) that cost me £170 to buy off (and that was over 10 years ago).
- o **Pavement licence:** Following the Covid-19 outbreak in the UK, the government put a number of measures in place to allow restaurants and pubs in England to apply for pavement licences, effectively to serve more customers outdoors. Additionally, there were changes to the Licensing Act to authorise them to serve alcohol for consumption off site.
- o **BUSINESS NAMES ACT & BUSINESS SIGNAGE:** In most countries (particularly those with any foundation in English law, as opposed to those with foundation in Roman law), you will have to follow rules and regulations surrounding what you call your business and where you display relevant contact information. Additionally, signs must not be misleading under consumer protection regs, as well as under planning regulations (which may vary based on whether a sign is fully, partially or non-illuminated and where it is situated in relation to the highway). In the UK, a system of *brown tourist signs* also exists that is open to applications from attractions and accommodation providers in order to better promote their businesses (similar systems operate in Europe and North America).
- o **DATA PROTECTION & GDPR – GENERAL DATA PROTECTION REGULATION:** This regulation changed for the UK with Brexit (when EU GDPR laws were

incorporated into UK law). In the US, the laws are complex and are covered by local, state and federal privacy laws and regulations. At state level, California is leading the way with comprehensive state data protection legislation (and other states are following suit). At a national level, the US Federal Trade Commission (FTC) aims to protect consumers against unfair or deceptive trade practices, as well as to take enforcement actions against businesses for unfair privacy and data security practices, particularly investigating and taking action against companies for:

- Failing to implement reasonable data security measures;
- Making materially inaccurate or misleading privacy and security statements, including in privacy policies;
- Failing to abide by applicable industry self-regulatory principles;
- Transferring or attempting to transfer personal information to an acquiring entity in a bankruptcy or M&A (mergers and acquisitions) transaction, in a manner not expressly disclosed on the applicable consumer privacy policy;
- Violating consumer privacy rights by collecting, using, sharing or failing to adequately protect consumer information, in violation of standards established in their prior enforcement precedents.

At state level, in most cases, the state attorney general is the enforcement authority when considering unfair and deceptive business practices and violations of consumer privacy.

In the UK, the government created a series of new offences that include:

- knowingly or recklessly obtaining or disclosing personal data without the consent-giving of the data controller, procuring such disclosure, or retaining the data obtained without consent.
- Selling, or offering to sell, personal data knowingly or recklessly obtained or disclosed would also be an offence.

And this is in addition to the existing rules governing the *data protection principles*, whereby it is incumbent on people using personal data to ensure information is used:

- fairly, lawfully and transparently;
- for specified, explicit purposes;
- in a way that is adequate, relevant and limited to only what is necessary; as well as ensuring data is:
- accurate and, where necessary, kept up to date;

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- kept for no longer than is necessary;
- handled in a way that ensures appropriate security, including protection against unlawful or unauthorised processing, access, loss, destruction or damage.

There is stronger protection for data considered sensitive (such as race, ethnicity, political opinion, religious beliefs, union membership, genetics, biometrics, health, and sex life or orientation). You might ask, why I'm banging on about data protection? Well, under Article 83(5)(a) 'infringements of the basic principles for processing personal data are subject to the highest tier of administrative fines'. Meaning failure to comply with the principles can expose a business to a maximum fine of up to £17.5 million, or 4% of the company's total worldwide annual turnover, whichever is higher! Don't think that you can pretend a breach hasn't happened either – there are short timeframes within which to report a data breach. In general, individuals have seven rights over their data:

- The right to be informed,
- The right of access,
- The right to rectification,
- The right to erasure,
- The right to restrict processing,
- The right to data portability,
- The right to object.

There are now also rights in relation to automated decision-making and profiling (watch out social networks). The rules also provide extra duty of care when dealing with the data of children and the consent of a legal guardian. The main take-away is that an individual's consent must be explicit and specific and they must opt in, rather than opt out as it used to be (and they must know precisely what it is they're opting in to). Importantly for hospitality professionals, don't think that data protection legislation is limited to protecting the names and email addresses of people on your mailing list. As a business you may also be liable where traditional operational practices are in use. For example, it used to be quite normal for the maître d' to check a guest's name against their room number (to confirm their entitlement to inclusive breakfast). However, if the printed list is left unattended, either in sight of, or easily accessed by the general public, the business may be liable under the Act (the same is true if the list is not properly disposed of).

- o Equality laws – these too have become more onerous over the last half a century, although it seems that the pendulum may be swinging back the other way in certain countries – make sure you know the prevailing law where you operate to avoid falling foul of it.

- o Hotel Proprietor's Act (or similar): If you operate a hotel and you accept a guest into your accommodation for at least one night, you are required by law to take responsibility for the safekeeping of all reasonable items of luggage brought in by the guest. This is a regular hotel, described as '*an establishment held out by the proprietor as offering food, drink and, if so required, sleeping accommodation, without special contract, to any traveller presenting himself who appears able and willing to pay a reasonable sum for the services and facilities provided and who is in a fit state to be received*'. Under the Act, the hotelier is fully liable for loss or damage to the guest's property that is caused solely by their negligence or that of their staff or your/their wilful acts. Additionally, where any goods have been entrusted for safekeeping (which even includes those offered but refused to be taken!). While it may be possible in certain circumstances to limit the liability where the above does not apply, the only other exclusions where the hotelier is not liable are cases where there is negligence on the part of the guest, or loss is caused by an 'Act of God'. Tough break, huh! In addition, as the law currently stands, if you are able to accommodate eight or more guests, it is necessary to display current bedroom tariffs, including what is included (meals, service charges and VAT). You must also keep a register of guests (who must be +16 years old to register/check-in).
- o TRADE DESCRIPTIONS: This varies in its format across the globe, but is designed to prevent companies from making misleading statements about their products or offerings. This generally goes beyond *trader's puff* – a gimmick/deliberately exaggerated claim made by a vendor to attract customers. As a rule, *puffs* tend to be vague and therefore difficult to prove, plus are never meant to be taken literally, so there is no intention for them to be legally bound, and do not give rise to legal consequences. An often used example of a puff is '*you'll have the time of your life at our theme park*'. In contract law, a puff, like other pre-contractual statements such as terms or representations are usually oral and so it can be difficult to determine whether they form part of a contract or not. Puffs differ from representations or terms in that the latter two provide remedies in law for an aggrieved party, with a term being a *promise*, while a representation is not. Consequently, a breach of terms will allow for an automatic claim for damages, while a misrepresentation will only do so if the representation can be proven to be fraudulent or negligent. Similarly, false descriptions usually require the normal proof of *mens rea* (guilty intent). This whole area is covered in the EU by the European Communities' *Consumer Protection from Unfair Trading Regulations 2008*. In the US, consumer protection laws prohibit unfair and deceptive business practices.

1 PLANNING PERMISSION & BUILDING REGULATIONS: Aside from specific acts or statutory law concerning hospitality already mentioned, it is very likely that you will be required to obtain the necessary permissions and/or licences to carry on your chosen activity in the location you've chosen to do it in. This usually starts with *Planning Consent* (or *Building Permit* in the US).

In most areas, building development is regulated and this is primarily for two reasons: firstly, to ensure the appropriate buildings are built in the selected

areas, and secondly, to ensure what is built is safe for its intended use. In the UK, the former point is covered under the prevailing planning regime (building permit in the US) in the relevant area and the latter under building control (building code). If you're starting a business (such as a restaurant or guesthouse) in a premises, constructing a new building, or converting, extending or making other structural alterations to an existing building (or demolishing one), you will need planning permission. Matters concerning planning permission are handled by the local planning authority in the UK (subject to national rules set by government) and town planners and local government in the US. If you do not get planning permission, you may be subject to prosecution, penalties and fines, and in the most extreme cases, even demolition of the unauthorised development.

The rules around planning permission for change of use, construction of a new building or alterations to an existing one can be very complex and securing a consent will almost certainly be easier with proper professional advice (unless you are a seasoned property mogul with a specialist in-house team).

Note: if you are buying an existing business premises, you cannot necessarily assume that it has historically been granted planning permission. I would strongly advise you or your solicitor (lawyer) to independently check that it is compliant before completing any transaction (particularly as in the UK it is no longer a criminal offence to produce misleading property particulars).

*Planning* is a very specialist area of real estate and it is important to consult with an expert in most circumstances. There are lots of different bodies with vested interests in the decisions and outcomes of the planning system, from nefarious neighbours to local pressure groups. Indeed, national government is often keen to *simplify* the planning process as a means of promoting increased development (and thereby deliver the economic growth they promised in their election manifesto). So, as with other regulations, the rules concerning *planning* are constantly evolving. It is therefore often worthwhile to contact your local planning authority office for advice on the current planning priorities and how your project is likely to be viewed, sooner rather than later. In most cases, it will be helpful to build a good working relationship with them, not least of all because you can rest assured your plans will be reviewed closely by both the local planning department and by building control before permission is granted. You are then also likely to be visited on site by the latter before, during and after construction (a visit from the planning officer is also quite probable).

In the US, the planning authority will work within established districts or *zones*. *Zoning* divides areas (within cities or counties) into different zones that restrict how land in a particular area is used (this is enforced by the police using land use laws and includes privately owned property). In England and Wales, zoning of land use was covered by Unitary Development Plans

(UDPs), Structure Plans and Local Plans until they were replaced with Local Development Frameworks (the latter represented the government of the time's effort to *simplify* the process by handing greater authority to district councils to determine what is built in their local area).

Whichever side of the pond you're talking about, or whether you're north or south of the equator, the point of zoning is to ensure that developments are appropriate for their surroundings, and you don't end up with a nightclub

| Use Class   | Description   |
|---|---|
| <b>A1 – Shops</b>                                 | hairdressers, <i>internet cafes</i> , <i>sandwich bars</i> , shops (from pets to post offices, travel agents, showrooms & undertakers).   |
| <b>A2 – Financial &amp; Professional Services</b> | Banks & building societies, professional services (incl. estate & employment agencies).   |
| <b>A3 – Restaurants &amp; Cafes</b>               | For the sale of food & drink for consumption <i>on the premises</i> .   |
| <b>A4 – Drinking Establishments</b>               | Public houses, wine bars & others (excl. nightclubs).   |
| <b>A5 – Hot Food Takeaways</b>                    | For the sale of hot food for consumption <i>off the premises</i> .  |
| <b>B1 – Business</b>                              | Offices (other than A2), R&D premises, light industry (appropriate in residential area).  |
| <b>B2 – General Industrial</b>                    | Use for industrial process (other than B1 (excl. incineration, etc, landfill or hazardous waste).   |
| <b>B8 – Storage or Distribution</b>               | Open-air storage (sea containers, etc)  |
| <b>C1 – Hotels</b>                                | <i>Hotels, boarding &amp; guest houses</i> where no significant care provided (excl. hostels).  |
| <b>C2 – Residential Institutions</b>              | Residential care & nursing homes, hospitals, <i>residential colleges &amp; training centres</i> .   |
| <b>C2A – Secure Residential Institutions</b>      | Prisons, detention / custody & secure training centres, secure hospitals & <i>military barracks</i> .   |
| <b>C3 – Dwelling Houses</b>                       | C3(a) single person or families, domestic employees (au pair, nurse, chauffeur, gardener, etc), carer, foster parent & children.<br>C3(b): up to six people living together as a single household.<br>C3(c): up to six people living together as a single household (not C4) not related.<br>Small shared houses (3-6 unrelated individuals who share basic amenities). |
| <b>C4 – Houses in Multiple Occupation</b>         |   |
| <b>D1 – Non-Residential Institutions</b>          | Clinics, health centres, crèches/ nurseries, schools, galleries, museums, libraries, places of worship, church halls, courts.   |
| <b>D2 – Assembly &amp; Leisure</b>                | Bingo concert/music halls, cinemas, gyms, swimming baths, skating rinks etc.  |
| <b>Sui Generis -</b>                              | Literally “of their own kind” e.g. betting shops, casinos, <i>hostels, nightclubs, theatres, taxis shops</i>  |

**Figure 3.5** The old planning use classes for property in the UK as an illustration of how land use might be described in your jurisdiction

being built next to a school or in a residential area, for example. Different districts will have different priorities, whether they are housing, employment, open space, amenity or others.

Figure 3.5 is a representation of how the system used to work in the UK, as a general guide (this has since been updated) with 16 distinct use classes.

If you wanted to build anything you would be likely to only get planning permission if your proposed use fitted one of the use classes designated for that particular location.

As a side note, the Latin, *sui generis*, includes '*premises/locations unique in themselves*'. SG includes locations where two or more uses exist at the same time, like a shop and post office (unless one of those uses is ancillary to the main use e.g. a church with a gift shop).

Whatever your jurisdiction, gaining planning permission and approval from building regulations/control are the essential first step before you start any works. It is highly advisable to contact the planning department of your local public administration/authority for advice on planning permission as early as possible.

Recently, there has been a lot of discussion surrounding the impact of *second homes* and *holiday lets* on rural and coastal communities. While you may feel it is your legitimate right to open your doors to Airbnb or Vrbo guests, there is some evidence that this can negatively impact existing hotels and guest-houses in the local area. Similarly, your hard work may have earned you the ability to buy a holiday home by the beach, but does this remove a home from the local stock for someone who was born in the area or price them out of the market? Because of the potential for unintended consequences or perverse incentives, I am generally opposed to governmental interference, when it comes to matters such as these (including over-tourism). However, there are clearly shortcomings to the market mechanism, which often takes too long to find a sustainable equilibrium or balance. In my opinion, because they're punitive and operate a zero-sum game, tourist taxes are a no-no. Similarly, preventing or punishing people for owning more than one home actually reduces the availability of rental homes in the private rented sector rather than improving the availability of housing. However, where I do agree with government is on the idea that if you wish to let bedrooms short-term, as a business, you should be required to have planning consent to do so and pay business taxes accordingly (although planning law still remains ambiguous on this matter in the UK, and it is not even clear, for example, as to what extent of alteration constitutes a material change in purpose). As things stand, planners will probably assess how much of the building is given over to the business vs how much remains purely residential as a measure of material purpose. If you receive guests on commercial terms, it is likely that you will

be required to make alterations to your property and contents to ensure you are compliant with building control, and health and safety regulations, particularly those relating to fire and evacuation.

## 2 Asbestos

Another matter to consider early on if you are converting a building or planning to remodel it, is asbestos – a naturally occurring fibrous silicate mineral that has crystallised to form fibres, which are resistant to fire, chemicals, mechanical and biological degradation. Its first known usage was in ceramics around 4,500 years ago. Its unique properties made it particularly good as insulation for buildings (particularly in asbestos cement and lagging), boilers, car brakes, pipes and in ships. Consequently, its use has historically been widespread across the globe. Unfortunately, asbestos also has some extremely dangerous properties that give rise to health risks, especially if inhaled (usually as dust). These take the form of respiratory conditions, such as mesothelioma, asbestosis, and lung cancer that often do not appear until many years after exposure and are typically fatal. Despite the toxicity of the substance becoming apparent as early as 1898 (Annual Report of the Chief Inspector of Factories and Workshops), asbestos was still used in caulk, drywalling, popcorn ceilings and plaster, vinyl tiles, countertops and even in artificial snow (flocking), as well as in fireproofing in stage curtains, fire blankets, fire doors and so on, even until relatively recently. It began to be popular in construction in the 1930s and became prevalent from the 1960s until it was banned circa 1980. It is likely, therefore, that any building erected during this period will have used it. If you discover asbestos in a building, it must be recorded in a register and either ‘managed’ or removed. If in doubt, get expert advice and remember asbestos is generally deemed safe as long as it is not interfered with or disturbed. If it becomes necessary to remove asbestos, it must be done by trained, qualified professionals wearing protective clothing and breathing equipment and placed in sealed skips (dumpsters). Consequently, the cost of removal is high – some 20 years ago, I had to have asbestos pipe lagging commercially removed from a hotel I bought, at a cost of over £160,000 (plus the property also had to close for 10 days, which was inconvenient for guests and cost around £40,000 in lost revenue). So I urge you to do extensive due diligence when buying a ‘project’ building.

## 3 Food Labelling, Safety & Hygiene

As with other matters mentioned in this chapter, there are regional variations to regulations and practices and it is important to check with your incumbent food, health and safety authority. Generally, you mustn’t offer food that is unsafe or unfit for human consumption, using food safety protocols, based on the principles of Hazard Analysis and Critical Control Point (HACCP) system that governs storage and preparation; you must cook and keep food at minimum and maximum temperatures to ensure they are safe to eat.

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4 **Allergies** – approximately 2% of the population is allergic to a certain food, although it seems that this number is rising and is dwarfed by the numbers who suffer food intolerances. People who suffer from allergies (who may not even know they have an allergy) can become seriously ill and even die from extreme reactions to certain foods. It is your responsibility to ensure the food your customers eat is safe and the quality is what they expect – this includes making them aware if it contains any of the 14 most common allergens:

- Celery (including celeriac);
- Cereals containing gluten, namely: wheat (such as spelt and Khorasan wheat), rye, barley, oats;
- Crustaceans, for example: prawns, crabs, lobster, crayfish;
- Eggs;
- Fish;
- Lupin, which includes lupin seeds and flour and can be found in types of bread, pastries and pasta;
- Milk (including lactose);
- Molluscs, for example: mussels, whelks, oysters, snails and squid;
- Mustard;
- Nuts, namely: almonds, hazelnuts, walnuts, cashews, pecan nuts, Brazil nuts, pistachio nuts, macadamia (or Queensland) nuts;
- Peanuts;
- Sesame;
- Soybeans;
- Sulphur dioxide/sulphites, where added and at a level above 10mg/kg or 10mg/L in the finished product. This is often used as a preservative in dried fruit.

These days foods usually have a label with a full ingredients list with allergenic ingredients highlighted. Following a number of fatal incidents, the labelling requirements for *prepacked for direct sale* food have been significantly tightened. This applies especially to food packaged at the same place as it is offered to customers that is in its packaging before the customer orders or selects it (fully or partly enclosed) and that is ready for final sale (such as pre-packed sandwiches), as well as any unwrapped/packaged food (e.g. items written on a chalk board, in a menu, or described by a member of staff). Make sure you keep your staff informed about allergens contained in the foods they serve, as well as the importance of informing customers. Additionally, calorie labelling has

started to be introduced in many places to make customers more aware of the calories in the food they eat to help reduce obesity and related disease. The same is true of food containing, consisting of, or produced from genetically modified organisms which must be labelled as such (excluding foods made using GM technology that is not an ingredient e.g. eggs/meat/milk from animals fed on GM feed).

## 5 Food Hygiene – In general, you should comply with the following:

- Keep premises clean, well-maintained and designed to enable good hygiene practices; have adequate hand-washing facilities, with supplies of hot and cold water, and drying facilities suitably located and designated for cleaning hands (toilets must not open directly into rooms where food is handled);
- Have adequate means of ventilation, lighting and drainage (this varies depending on the nature and scale of the business); additionally, in all rooms where food is prepared, surface finishes to walls, doors, floors and equipment should be easy to clean and, if necessary, to disinfect, with adequate facilities for cleaning work tools and equipment and for washing food.
  - cleaning chemicals must not be stored in areas where food is handled; equipment and other items which come into contact with food must be kept clean and well-maintained (including allowing for the cleaning of the surrounding area);
  - food waste must not be allowed to accumulate and should be kept in closed containers which are easy to clean and disinfect, and the waste must be disposed of in a hygienic and environmentally-friendly way;
  - all staff involved in food preparation or service should maintain a high level of personal hygiene/cleanliness (including clean clothes/uniform), plus anyone suffering from illness that could cause contamination must not work in a food handling area. They should also report the condition;
  - food must be protected from possible contamination from pests;
  - all staff handling food must receive training commensurate or appropriate to the work they do;
  - only buy raw materials for food preparation that is fit for human consumption and you must maintain an adequate water supply that ensures food is not contaminated (or any ice made from it), as well as providing a supply of drinking water.

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- **Ready-to-eat Foods** (e.g. sandwiches, salads, desserts, cold cooked meats and items cooked in advance to serve cold) – because they will in likelihood be consumed without further cooking or temperature control, it is important to handle ready-to-eat foods carefully to avoid food poisoning. In practice this means: avoiding cross contamination by using clean knives, utensils and separate boards for the preparation of ready-to-eat foods; checking products are within date; checking packaging is not damaged; checking the temperature of purchased frozen and chilled ready-to-eat foods is correct (under 8°C for chilled foods, -18°C for frozen foods); keeping foods covered after preparation and keeping them at room temperature for as short a time as possible (it is highly advisable to buy a thermocouple or probe thermometer even in a domestic setting and is essential in commercial environments to monitor temperatures – this should also be thoroughly cleaned between readings and uses to avoid contamination); rotating stock correctly and not using products after their '*use by*' date; sanitising chopping boards, surfaces and utensils after use; storing ready-to-eat food at the correct temperature; following the manufacturer's instructions on storage and preparation; storing ready-to-eat foods separately from raw foods that require cooking (e.g. meat, poultry, eggs, etc.); and washing hands before preparation.
- **Temperature** - you must not keep foods at a temperature that might make them unsafe to eat. Foods identified as needing temperature control for safety must be held at or above a minimum temperature of 63°C for hot food and at or below a maximum temperature of 8°C for chilled food. Foods that are likely to see the growth of harmful bacteria and/or toxins should not be kept at temperatures which would result in a risk to health. Obvious exemptions to the 8°C limit include: bakery products (provided they are to be used quickly); food that needs to ripen at room temperature (including some cheeses); most unopened canned or dried food. Additionally, food that should normally be kept at or below 8°C may be kept above that temperature for a single period of four hours to allow it to be served or displayed (e.g. on a buffet), provided afterwards it is disposed of chilled back to 8°C or below. Similarly, food to be served hot may be kept on display outside the control temperature of 63°C (or above) for a single period of two hours. If any food is left after this time, food should either be discarded or reheated to at least 63°C (in Scotland this is to 82° or above), or cooled as quickly as possible to 8°C or below until final consumption.

In the UK the Food Safety Agency provides useful information and guidance to support operators with all of this. In the EU it is the European Food Safety Authority, while in the US there are various government bodies that cover food

safety throughout the supply chain, but it is primarily down to the Food and Drug Administration (FDA) as part of the Department of Health and Human Services (which is responsible for protecting and promoting public health through the control and supervision of food safety).

Before we close out this chapter, I should probably briefly mention virtual real estate. As things currently stand, there is little or no legislation covering online real estate, by which I specifically mean augmented reality (AR) and the like. In other words, the law is unclear as to whether you could stop someone from tagging your business premises with an AR tag i.e. a competitor could feasibly place an AR advert for their business on top of yours at your location. Now this could only be viewed through an electronic device (it's only electronic squatting, after all), but still, if technology leads in this direction more generally, this could in time become a problem.

In conclusion to this chapter, I leave you with the following from Mark Twain: 'Buy land, they're not making it anymore'.

# Chapter 4

## P2: PURPOSE (The Why)

### People and their Motivations

#### Introduction

As mentioned, 50% of hospitality is the people and the ‘entertainment’ they offer, which really boils down to the why of what you’re doing and why your guests might care. People tend to come to your business not primarily because of the lower order urges of food, water, shelter, sex and security; they tend to come to fulfil their higher order needs of social interaction and self-actualisation (although primal desires do sometimes play a significant, if subconscious, part in their decision-making, too). Your guests will have varying motives to visit with you and the better you understand them, the better you will be able to provide for and market to them – the cost of acquisition of a new guest is estimated at between 5 and 10 times higher than that of retaining an existing guest.

Sandwiched between the hard real estate world of *Place* and the equally and arguably harder financial world of *Profit* (coming up after this chapter) is the soft human bit of *Purpose* – rather like the pink jelly of the brain set between the sides of the bony skull that protects it. In some respects, this chapter, *Purpose*, might just have easily been named *People* as it includes all the emotional things that are important vis-à-vis your staff, customers, competitors and...you. However, it is the *why* that we’re really interested in here: simply discussing *people* misses the point and the reason I chose *Purpose* rather than *People* as a chapter header is that *Purpose* gets us closer to people’s motivations, specifically their *why*’s. To me, people are truly

interesting, but it's the *why* behind them and what they do that is absolutely fascinating. *Why* will your customers come to you and *why* do they choose you over your competitors? *Why* will people work for you (often with little financial incentive)? *Why* are you doing what you're proposing to do – think back to the Questions of Discovery; did you spot a gap in the market, did you always want to do this, get fed up with working for someone else, or a combination? (incidentally, my observation is that on this last point, you should never run from something, only ever towards it – I'll say no more, your *why* is personal to you and only you know how excited and motivated you will be in your pursuit of success). We have looked a little at your motivations for starting your project and we will consider its physical manifestation in *Concept* later in the book. We will also briefly consider your staff and their project management under operations and asset management. For now, I want you to think about your potential customers, or guests as we now know them.

So what prompts people to do what they do or behave the way they behave? Understanding the human condition, or at least having a go, is vital to you in your new role as hospitality CEO, CMO, Senior Sales or Brand Director, Business Planner or VP of FPA (Financial Planning and Analysis), Human Resources Manager...the list goes on. There are many motivations for why people behave in the way they do, and while some are conscious, many are not, which can be a problem for those trying to analyse them. Indeed, as the business tycoon and the Father of Advertising, David Ogilvy famously quipped, '*The trouble [with market research] is that people don't think what they feel, they don't say what they think and they don't do what they say*'. We clearly need to go deep if we're going to get to anywhere near the bottom of human motivation. Interestingly, having studied at Oxford, Ogilvy started his work career in hospitality, specifically the kitchens of Hotel Majestic in Paris.

When I studied as an undergrad, the prevailing wisdom on human motivation came from American psychologist Abraham Maslow's *A Theory of Human Motivation* (1943 – it was already half a century old then!). In the original paper, Maslow developed his *hierarchy of needs*, a theory that organizes human needs with the most basic needs at the bottom and the most advanced at the top:

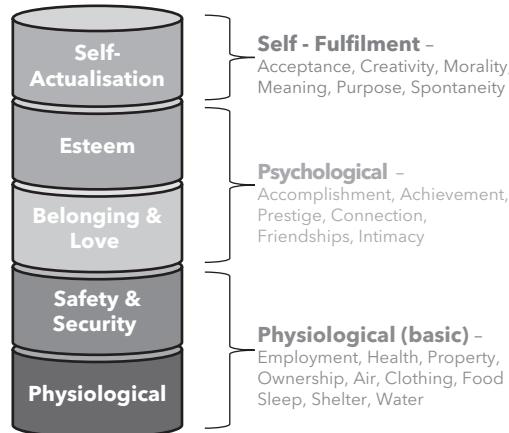
**Self-actualization:** The need to achieve one's full potential and be creative;

**Esteem:** The need for respect, recognition, status, self-esteem, confidence, and a sense of achievement;

**Social & Belonging:** The need for friendship, intimacy, and acceptance;

**Safety:** The need to feel safe, physically, financially, or in terms of job security and health;

**Physiological:** The most basic needs, such as food, water, shelter and rest.



**Figure 4.1** Maslow's Hierarchy of Needs presented as an interchangeable tower structure rather than the traditional pyramid where base needs must be fulfilled before higher order needs can be addressed

The hierarchy is sometimes represented as a triangle or pyramid, suggesting that the most basic needs, the bottom tier, are the most significant (the widest part of the pyramid) and must be fulfilled before the next level up can be addressed, and so on up the hierarchy in a diminishing degrees of significance (all built one on top of the other). However, today, the hierarchy is neither considered to be organised in this way, nor static in its construction, with needs changing in intensity and significance level depending on circumstances and stimuli. Additionally, Maslow never included the iconic pyramid design that some of us recall.

While contemporary experts may consider alternative motivations, such as admiration, success, love, and caring for your kind, or, as with self-determination theory, autonomy (the need to be empowered to make choices and feel in control), competence, and relatedness (the need for social connection interaction and relevance), for our purposes, we will stick with Maslow for now.

As the diagram illustrates, the needs hierarchy is sub-divided into self-fulfilment, psychological and physiological groups. Different components of the hierarchy can be driven by conscious or automatic processes, and to varying degrees, dependent on circumstances. For example, if you have a food and beverage offering, the chances are that people will not come to you primarily because they are starving or thirsty. They might be a bit hungry, but their main reason for eating out could be to save time for other activities, for a leisure experience, or to demonstrate their social status. In the accommodation side of hospitality, we would normally group customer purpose or motivation into business or leisure,

and then subdivide it again into individuals or groups (typically considered to be more than 6 people) as follows:

- i) **Business** – independent travellers visiting a location to conduct business in that location. Sometimes referred to as Frequent Independent Travellers, FITs). Incentive groups i.e. people attending a location for board meetings, team building and so on, where it is combined with leisure activities as a form of reward. Incentive travel is considered to be different from conferences, where attendees are there predominantly for work. Then there will be specialist groups, like airline staff, who will be afforded different levels of accommodation depending on airline, location, whether they're flying long-haul or short-haul, overnight stop, etc.
- ii) **Leisure** – individuals and families on holiday or groups organised by tour operators. Then there will be those attending weddings or other leisure events.

The gathering of your customers into these categories is known as segmentation. The main reason for segmenting an audience should be to develop and focus your messaging to target specific customers more effectively (to adjust what you say about what you offer to best fit their needs and desires, in a way that they understand and relate to). However, the finance and business planning department will wish to think about travellers in this way for slightly different reasons – these groupings describe when people have a greater propensity to visit you (weekdays or weekends, during the holidays or the main business months), and the prices they are likely to accept or the level of discounting they expect (a large conference group will typically want *delegate* room rates lower than a FIT, and tour operators will need significant volume discounts to make the margin on their package offerings work). We will consider all this when we look at building a P&L (trading Profit and Loss account), but just to illustrate segmentation from a finance perspective:

If we take a city centre hotel of 100 bedrooms, open for 365 days a year, there are 36,500 rooms available per year. Approximately 10,429 nights are at the weekends (Fri & Sat) and 26,071 nights are during the week (Sun to Thurs). Then, if total weekday occupancy = 85% that means  $26,071 \times 0.85 = 22,161$  room nights sold annually during the week. Similarly, if total weekend occupancy = 60% that means  $10,429 \times 0.6 = 6,257$  room nights sold annually at weekends. Combined, that is a total of 28,418 room nights sold per year, equivalent to average annual bedroom occupancy of 78%.

Assume the published tariff for the hotel is \$150 (excluding any taxes), which positions it as a good mid-market property. Now different customers will expect to pay different tariffs, depending on how busy the hotel is, who is paying, and the degree of flexibility of the dates for their stay (in practice this is down to the purpose of their visit, per segment, as above).

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A business guest who needs to fly into the city for a client meeting near the hotel at 10.00 am on the Tuesday of that week, absolutely has to stay at the hotel the night before. They don't mind the price they pay (they are insensitive to price) as the cost is covered by their firm (which in turn expects it will be covered by future fees billed). With this in mind, and as the hotel is busy midweek, it is likely that there will be no discount off the published tariff for this business guest. They'll pay \$150 per night (and they travel alone).

By contrast, a couple decide they want to show their young kid the city where Gramps grew up. They can't visit during the week because of school, so they plump for a weekend in May, when the hotel is relatively quiet. They are price sensitive and demand for the hotel is low at this time and so they may get a discount of \$75 meaning they pay \$75 for the night (for all three of them).

Now if each of these scenarios reflected the average business guest and the average leisure guest, you would have 22,161 nights where the average room rate paid was \$150 (a total room revenue of \$3,324,107) and 6,257 nights when the average room rate paid was \$75 (a total of \$469,286). At this hotel, room revenue from business guests amounts to 88% of total room revenue, while our leisure guests account for only 12% of total room revenue: where do you spend your marketing dollars in this scenario? When do you staff-up and when do you run a skeleton team? When are you going to need more hot water or breakfasts? This last point, as you will have guessed, becomes more complicated because of the average number of guests per room. However, when directing your efforts and resources to attracting and retaining guests, it is important to bear two things in mind:

- i) Don't direct disproportionate resources on frequent, loyal users, who have already bought into your brand. Business leaders often get this wrong because it is easier to make these guests happy and garner their positive feedback – either unknowingly for the warm glow or on occasion, to game the internal system for their personal benefit.
- ii) Do direct resources to customers who are close to purchasing or close to being regular repeat customers rather than those who have very low brand awareness or who are dissatisfied with your offering. You only need spend a fraction of your budget to convert the close-to-purchase and nearly loyal, compared to the millions you will need to spend merely trying to get the attention of your brand agnostics or deeply unhappy to come to you.

Now, while it is useful for the purposes of projecting or forecasting business performance to group guests into basic segments (based on purpose of visit), we need to further develop the profile of individual users beyond simple stereotypes – as with most things in life and as Ted Lasso might say, it is better to be curious than judgemental. We need to remember customers are humans too, not just data.

The next stage, therefore, in building a profile is to transition from talking about customers in terms of what we instinctively think we know about them, to what we actually do know about them – age, preferred activities, preferred media buying and social networks, gender, stage of life, occupation, as examples. What we can distil from researching the above helps us build a personality picture, referred to as a persona. A persona takes a generalised stereotype of a group, and builds in individual nuance. We will talk more about this when we look at marketing, but just to add to your confusion, branding relies on archetypes, which are generic versions of people or personalities. Again, they are different from stereotypes in that they are based on actual rather than inferred characteristics.

Now, thinking specifically about actual rather than inferred characteristics, we do need to be cognisant of something called fundamental attribution – a cognitive bias or mistake in our thinking or perception that illustrates the need to stick to fact rather than inference. Fundamental attribution error is when we bestow behaviours on others, based on what we believe to be their personality. If I were to say to you that *Nigel* is a senior nurse in A&E (that's the emergency room in the US) and that on his time off he volunteers at an animal sanctuary, you would likely infer that by nature, he is a very caring, patient person. So if you saw *Nigel* surrounded by begging children while on vacation, you might be surprised when he loses his temper, snaps at them and brushes them aside as he heads for a taxi. You have in this instance, as we all have a tendency to, attributed what you know of him and the character traits associated with his job and lifestyle choices, to form a view of what he predictively *should* be like in all situations, at all times. This, however, ignores what you don't know about him and what is happening in the moment, yet context is almost everything in determining behaviour. What you didn't know was that *Nigel* has PTSD from his work, he is claustrophobic since childhood, and suffers from the heat and it's 90 degrees out there. An academic study found that trainee priests (who identified themselves as joining the priesthood to help others) were just as likely to walk past an individual in need of help as anyone else when running late. It wasn't that they didn't care or that they considered their appointment more important, they were simply distracted by their immediate lateness, to the point they didn't have the cognitive capacity (or subconscious desire) to think outside their immediate condition – their brains were overloaded. This type of overload can happen a lot in humans, particularly as our world becomes busier and more complex, and in response, we tend to follow what we did before in a similar situation, or we allow subconscious, instinctual responses to govern our behaviour.

In providing the example of *Nigel*, I did two things: firstly I told you a story, albeit it a short one (from which you were inclined to make all sorts of assumptions about him) and secondly, I painted you a mental picture of a scenario involving *Nigel*. Interestingly, as we will see in a bit, a lot of the way we understand the world and our place in it, is through both stories and images, or more specifically,

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stories through images. The idea of our world view being developed partly through images, doesn't necessarily sound surprising, until you know that your visual cortex (the part of the brain associated with sight and seeing) shows the same activity when you ask subjects to imagine an object, situation or place, as when they look at it in real life or indeed an image of it. The act of just thinking about it causes that part of the brain to light up. To that extent, it's the same part(s) of the brain that translate the bytes of data created by an actual object when transmitted from the eyes into an image in the mind, as the one that conjures images from our memories or what we expect to see. This realisation is extremely important, as it directly impacts how we respond to stimuli.

We have a tendency to experience what we expect to experience or want to experience, what we expect to see, hear, smell, taste or touch. In an experiment conducted at a university refectory in the US, the same icing sugar-dusted brownies were given as free samples to students, who were then asked to rate their taste. The only variation between batches was presentation – some were offered on napkins, some on paper plates and some on crockery. Those presented on plates were perceived to taste significantly better. Similar tests have been conducted using multiple product types and we can probably relate fairly easily when it is words used to generate the same effect. For instance, how does the following menu description sound: *homegrown heirloom tomato bruschetta, drizzled with Italian olive oil, kissed with roasted garlic, and served on freshly baked, fire-grilled bread* sound... compared to *tomatoes on toast*? Context is everything, even if it is imagined.

The next thing we have to consider is the impact of effort or perceived effort on our perception of a product or service. The value of effort seemingly works on both sides of the equation – we consider something of greater value when we perceive that someone has put effort into creating that something and we also value something more highly when we have been involved in its creation. In scientific tests of other people's effort, wine poured from bottles sealed with corks was considered to taste better (deeper, richer flavours) than that poured from bottles sealed with screwcaps. When interrogated more deeply, the evidence showed it was the effort of drawing the cork from the bottle that made the difference, and not the nature of cork as a means of stoppering the container. Similarly, putting our own effort into something triggers either the generation effect or the Ikea effect. The Ikea effect was identified when some participants were asked to build a flat-pack black box, while others were simply issued a completed box, before stating how much they liked the box and how much they would pay for it. While objectively the boxes were identical, those who had constructed the box themselves liked it better and valued it more highly. The generation effect is similar, except that it involves merely the effort of thinking. Following testing, it is apparent that people asked to recall a statement are more likely to remember it if it has been presented as a question, even obliquely. As brand recall is a crucial first step on the path to purchase, this becomes significant. To explain, if an advert says

*'did you know that eating bananas boosts potassium in your system and so reduces muscle cramp'*, it will be more easily recalled than the simple statement *'eating bananas boosts potassium in your system and so reduces muscle cramp'*. The effort of answering the question makes the memory stickier. The generation effect can also be activated by asking the reader to complete a sentence or by getting them to answer an indirect question, as beautifully illustrated in the advert in *The Economist*:

*'I never read 'The Economist'.*

*Management trainee. Aged 42'*

(The Choice Factory, Richard Shotton, 2019)

As the reader, you have to make sense of the advert and its hidden message, which takes effort and consequently, you are more likely to remember it.

So, we value increased effort, whether ours or someone else's, and we are susceptible to visualisation or visual suggestion, whether that's a product or a scenario. The third thing, which I believe we need to reflect upon, particularly in the hospitality business, is group membership. What do I mean by this? Well, as Maslow highlights in his non-pyramidal hierarchy, beyond our basic physiological urges, other needs are either related to self-fulfilment (which may be why you're reading this book and starting on your journey to running your own hospitality business), or psychological. I would suggest that self-actualisation, for the most part, does require other needs to be met, takes time to evolve or even unpack as a concept, and is deeply personal to each of us. The psychological needs of esteem, belonging and love are common to all of us (with personal interpretation in the specifics) and are fundamentally group-related. We care what the other members of our group think of us. We care where we fit in. We care about how we feel about ourselves in the context of the group, measuring ourselves by comparison. As a result, we adopt behaviours that reinforce the identity of the group and our identity within it, as well as the identity that we take from it. You may think that a heavily tattooed, pierced biker is expressing the ultimate signs of rebellion and independence, when in fact they are simply exhibiting and reinforcing the common behaviours of their particular group. The visual cues are merely the signalling of membership of the set, adherence to its norms and to a degree, the level of strength of the group dynamic, gained from the cost of commitment. To this end, the biker is no different from the billionaire who drives a Lamborghini, and goes on holiday to the Caribbean – they're just signalling their membership of their particular group.

Then of course, you have those of us who try and signal membership of groups that we don't belong to, at least not yet. Groups we might aspire to or wish to appropriate strength from via perceived membership. Think middle-class kids who show up at school adorned in a pale imitation of gang colours, or speaking in pseudo hip-hop language. Signalling group membership to the uninitiated,

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but wholly transparent to the real bad-asses of the true group. Before you peer down your nose, check that you're not doing the same thing in your own way – as a business person, do you join clubs and attend social events to signal that you are a member of the successful professional gang? I admit that if I peer under the table of my writing this book, it is in part to signal being an author and therefore convey membership of an intelligent gang, gaining strength and status from the reflected glory of a group of properly smart people. Possibly something to do with being told I was lazy as a kid – I'm sure you'll have your own desire for group belonging.

If you think that I'm overstating the importance we attach to belonging, and if you haven't already experienced it, imagine the feeling of running against the group and being pushed out of it. You may have a lightbulb moment and decide that you no longer think the way your contemporaries think, and start exhibiting independent thoughts and behaviours. Unless you are going to challenge and usurp the *alpha* to become leader of the group (indoctrinating all with your new ways), you have already become the maverick – the unbranded cattle that roams the range alone. While the new you may have been reborn in an instant following a eureka moment, your evacuation from the group may well be subtle and more gradual. A good example might be someone who decides to leave the large corporation they work for to do their own thing. They resign and at the leaving do, they get a few kind messages. For a while they're still included in the bants on the socials and get invited to team celebrations. Slowly, however, it starts drying up, the phone stops ringing and fewer people like their posts, as since they left, they somehow seem less relevant these days. In the old days, LinkedIn was full of job opportunities and recruiters called or messaged, today not so much – it can be tough being Captain Pete Mitchell. Our maverick needs a new home, to either create and lead a their own group or find a new one to join and belong to. Enough on this already, but I trust you get the point about the importance of groups to all of us.

The main reason for discussing group dynamics is to develop your understanding of how it can impact the behaviours of your guests. We will come back to this shortly, but first I think it is important to have a more complete understanding of how our minds work, and why some reactions and behaviours seemingly appear out of nowhere. Our investigation of customer motivation demonstrates that choices are determined by our conscious that says 'go here' or 'go there' for perfectly rational reasons, but also by the fears and drives of an autonomous side to our brain. To gain a fuller understanding, we'll have a look at the work of Nobel prize winner Daniel Kahneman and others, but before we do, we need to visit the forefather of psychology, Sigmund Freud (and to a lesser extent his one-time collaborator Carl Jung). We'll consider Jungian thinking later when we look at branding; for now, it is time to unpack what Freud determined to be the key components of the human mind or psyche: the Id, Ego and Super-Ego:

**Id** – our most primitive impulses (like Maslow's lower levels). It is entirely unconscious or instinctual, and it drives our most basic motivations, including sex drive (*Libido*) and aggression or destruction (*Thanatos*). The id is primarily concerned with instant gratification (the *Pleasure Principle*) of our sexual and aggressive urges (addictions, cruelty, and other pleasurable or harmful behaviours that otherwise distract us from being productive);

**Superego** – comes from our learned and inherited beliefs surrounding individual and societal morality and our responsibilities. The superego is highly judgemental and pushes us to behave *well* – making us feel guilt when we fall short of perfection. This might be very loosely akin to the higher-level motivations of the Maslow hierarchy and it is the societal norms upon which he and Jung agreed (which also form some of the basis for the use of archetypes in branding).

**Ego** – is the logical, reasoned, rational, conscious, cool, calm and collected element of our mind – our inner grown-up. It is the ego that will tell us to depose or delay our id motivations until a more appropriate time or in a more appropriate manner (the reality principle). Consequently, the ego finds itself mediating between the base instincts of id and the restraining forces of the superego. For example, if we are affronted by another human, the id may wish to lash out and punch them, yet the superego says *civilised* people just don't do that, while the ego tells us to chill out, reflect and reframe the slight, or at least go somewhere private to scream.

Such conflicts between the different departments of the brain can, according to Freud, challenge our self-image, and cause us anxiety and imbalance, with the ego trying to correct for the overpowering demands of the id to placate the superego. In such instances, he believed the ego resorts to subconscious defence mechanisms to help us get through our everyday lives. While much of Freud's work has been debunked by more recent understanding of human psychology, there are links between these coping mechanisms and what are called our biases (there's a lot more on this coming up shortly). To complete the picture, the following is a brief summary of the key mechanisms with examples of how they might be exhibited:

- **Denial** (or repression) – we witness an anxiety-generating event, but are unable to recall it happening;
- **Displacement** – we divert our anger away from a person attacking us and take it out on someone else weaker;
- **Projection** – we attribute insecurity on to someone else when we're struggling with our own insecurities;
- **Rationalisation** – we don't get a job and tell ourselves you didn't want or need it anyway;

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- **Reaction formation** – we secretly fancy *Tim* or *Jane*, but invert this and publicly state we loathe them;
- **Regression** – we are stressed about a test and start adopting childish behaviours, like sucking our thumb;
- **Sublimation** – we play physical contact sport to sublimate our aggression, or paint a sexualised picture to sublimate our sexual drives.

Regardless of how psychology has developed, I think we can imagine scenarios where some or all of the above might occur. It is probably worth briefly addressing the Freudian elephant in the room, his '*Stages of Psychosexual Development*' – the most controversial, and least scientifically valid, part of his work. In this theory, he stated that our personality is developed from childhood into adulthood through a series of psychosexual stages, each connected with a different part of the body – the mouth (oral – sucking, biting & chewing of babies), bowels & bladder (anal – evacuation and toilet training of toddlers), genitals (phallic – conflict from sexual desire for the opposite-sex parent). In addition to the oral, anal and phallic stages, he considered the two additional stages of latency (six years old to puberty, when sexual feelings are less important) and genital (puberty & post-puberty, when mature sexual orientation is achieved provided all of the previous steps have been adequately fulfilled). For example, an infant that doesn't receive enough sexual pleasure from sucking and drinking from its mother's breast, might, according to Freud, develop a fixation with breasts or regress to a similar fixation when under stress later in life as an adult. On this frankly weird note, let's leave Freud to history and move forward to modern psychology as far as it relates to you and your guests.

The sharper-eyed among you will have noticed that for the purposes of our exploration, I tend to use subconscious and unconscious interchangeably. This is not strictly correct, as the subconscious governs automatic actions/reactions without conscious thought, while the unconscious is where deep memories and past experiences are stored. To put it another way, the subconscious runs automatic processes such as breathing, as well as storing, retrieving and acting on relevant information that substantiate who we think we are – *I give to a charity fundraiser in the moment, because I am a charitable, giving person*. The unconscious, by contrast, will hold first impressions/experiences and base instincts, resulting in our ability to develop implicit perceptions and thoughts. Whilst our subconscious is only partly available for introspection, we generally don't notice it without serious focus, and we can't access our unconscious mind at all (except possibly through hypnosis and even then we require a third party to conduct the analysis; we are not aware of it).

Emerson Pugh's quote from over 100 years ago perfectly frames the limitations of our voyage of discovery: '*If the human brain were so simple that we could understand it, we would be so simple that we couldn't*.' Similar quotes are widely attributed, but I was

first introduced to it by the Stanford University neuroscientist David Eagleman, in his book *Incognito: The Secret Lives of the Brain* – an extremely enlightening and informative publication that gives plenty of food for thought.

The human mind is extremely complex and rich; indeed, it reflects millions of years of human development, with inherited characteristics and operating systems that often work independently of each other, consciously or otherwise. To wit '*It took millions of years for man's instincts to develop. It will take millions more for them to even vary. It is fashionable to talk about changing man. A communicator must be concerned with unchanging man. With his obsessive drive to survive, to be admired, to succeed, to love, to take care of his own.*

 (Bill Bernbach – the creative ad director from the real *Mad Men* era).

The indicators of our evolutionary journey come to the fore at different times and under different conditions, particularly stress and uncertainty. While thinking has developed considerably in recent years, the basic consensus is still broadly in line with Freud's Three Levels of Mind, which as I started to explain earlier, is akin to an iceberg – the conscious above the surface, the preconscious just below the water (the subconscious), while the great majority lurks further beneath (the unconscious). To expand:

- i) The Conscious Mind – the bit that is aware of our thinking and includes our thoughts, feelings, and sensations. It also takes the credit for all of the activity of the rest of the brain systems of which we are not aware. In the iceberg analogy, the conscious mind is the part above the surface that is visible and accessible.
- ii) The Preconscious Mind – which is close to the surface of consciousness. Comprising memories, thoughts, and feelings that can be easily brought to awareness. The preconscious mind is the part of the iceberg that exists just below the surface of the water; you can just about see it and might be able to access parts of it, while other areas are increasingly distorted or concealed the further you go down into the murky depths.
- iii) The Unconscious Mind: This is the deepest level of the mind, where most automatic thinking takes place and which holds repressed thoughts, feelings, and desires that are inaccessible by the conscious mind. The thoughts and processes remain largely hidden from awareness and we typically only see evidence of their existence indirectly through our behaviours after the act. These can exert a significant influence on our behaviour, even if we're unaware of them.

While the mind may broadly exist in these three states, many behavioural psychologists subscribe to the notion that our thinking and decision-making generally operate under a two-system mechanism, where unconscious and subconscious

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activities are combined into one system and conscious thinking the second. This two-system approach was first proposed by Daniel Kahneman (notably explained in his 2011 book 'Thinking, Fast and Slow'). Simply put, System 1 is our fast, intuitive, and automatic thinking system, operating efficiently and relatively effortlessly. System 1 tends to use a combination of learned intuitions and genetically or socially inherited instincts honed by evolution – like a craftsman who has learned his skills over years and can execute them with ease. By contrast, System 2 is our slower, deliberate and logical analytical machine. System 2 requires more effort, energy and focus, and is responsible for complex reasoning and calculation – more akin to an educated academic who has to work everything out methodically.

Kahneman's work built on a lifetime of research conducted in collaboration with a host of academics on the frontline of psychology, most notably Amos Tversky, with whom he worked when he won the Nobel prize in 2002. Surprisingly, this was for economics rather than cognitive psychology – for challenging the long-held *Homo Economicus* assumption i.e. that people are irrational, and not rational, utility maximising, pursuing of wealth for self-interest, while avoiding unnecessary work by using rational judgment. Up to this point, neoclassical economic theory, suggested homo economicus was an optimal decision-maker with perfect information and consistent goals. Tversky and Kahneman's work exploded this idea, suggesting that much of the time humans instead use heuristics (habitual behaviours or rules of thumb) and are subject to biases (an error in thinking or recollection) that they are typically not aware of. They showed that it is essential to allow for emotions when considering decision-making. Biases or thinking errors occur when people create their own 'subjective social reality' or view of the world based on their own perceptions that are typically limited in objectivity and open to distortions. These biases often unconsciously dictate behaviour and lead to inaccurate judgment, illogical interpretation, and *irrationality*. However, it would be wrong to dismiss biases as wrong or bad. They are simply the result of the brain's attempts to maximise efficiency in an ever-increasingly complex, data-filled world, where detailed analysis of every option is impractical or simply impossible.

In Kahneman's two-system model and under normal conditions, System 1 kicks in first and produces a fast, cognitively easy (light work) response to a situation or stimulus. Slower to the party is System 2, which, if it absolutely has to, eventually catches up, evaluates System 1's initial reaction and decides whether further slow, methodical, heavy-effort analysis is required. A great example of this in action is Prof. Shane Frederick's now famed bat and ball question – try it for yourself:

*A bat and a ball cost \$1.10 in total. The bat costs \$1.00 more than the ball. How much does the ball cost?*

Got the answer? Did you instantly, automatically *know* the answer was 10 cents? Or were you able to suppress this intuitive, but incorrect response with the logical, correct one? Wait, what? How can 10 cents be wrong? Let's slow it down

and take a look: if the bat and ball together cost \$1.10 and the bat costs \$1 more than the ball, then the ball cannot cost 10 cents. If the ball did cost \$0.10, the bat would have to cost \$0.10 plus \$1.00 (to cost \$1 more than the ball) and therefore the bat would by itself cost \$1.10 and together with the ball they would cost \$0.10 plus \$1.10 = \$1.20, so it doesn't work. The question states the sum of the two items is \$1.10 and one item is \$1.00 more than the other, so you must divide the 10 cents by two and allocate half to each item with + \$1.00 to the ball. Still wrestling to suppress the cognitive bias? Here's the equation in three steps:

i) If **Bat = Ball + \$1.00** and **Ball + Bat = \$1.10**

then,

$$\text{Ball} + (\text{Ball} + \$1.00) = \$1.10$$

and simplified, this gives you:

ii) **2Ball + \$1.00 = \$1.10**

so, subtracting \$1.00 from each side gives:

$$2\text{Ball} = \$0.10$$

then divide both sides by 2 ( $2\text{Ball}/2 = \$0.10/2$ ), to give you:

iii) **Ball = \$0.05** with the completed equation (numbers instead of words) looks like:

$$\$0.05 + (\$0.05 + \$1.00) = \$1.10$$

...which took a lot of effort to get to the correct, System 2 solution...much more effort than the instinctive, but wrong System 1 answer. However, we should not be too quick to chastise our brains for jumping to a wrong conclusion; there are evolutionary benefits to the fast, initial responses of System 1. Firstly, System 1 uses very little cognitive power and so burns fewer calories and secondly, it's lightening quick, which can on occasion be a significant survival advantage. Imagine an ancestor out gathering roots and fruits for dinner: suddenly their senses detect movement – a change in the shadows, a scent in the air, an unexpected sound. Before they have had time to think, they're off running, as fast as they can, in the opposite direction from the potential danger. A real threat and they just put a few extra life-saving paces between themselves and a hungry predator or nefarious rival. The *freeze, flight or fight* response is largely effortless and instant, automatically and unconsciously produced by System 1...and potentially the difference between life and death. A creature that operated purely on a System 2 response might well be still debating what the danger might be and the contingent alternative actions open to it, right up to the moment a powerful swipe from grizzly paw or human club knocked it into the middle of all eternity.

Somewhat ironically, the more advanced we become as a society and the further we get from our prehistoric past, the more we need its instinctive reactions

to navigate the growing mountain of information we must process just to get through each day. Think about it, we wake up and our tech informs us of the day's weather, traffic on our commute, stock prices, local, national and international news events, and that's before we've analysed the contents (and gaps) in the refrigerator and read the nutritional information on our breakfast cereal. Later, we check work emails and our socials...and all this information needs to be parsed, so we can decide which bits need action and what that action should look like. We simply couldn't process everything with System 2, it would take forever and require really hard work, consuming inordinate amounts of energy.

Our brains crave efficiency and loathe anything but the most essential effort – in the words of Daniel Kahneman ‘thinking is to humans as swimming is to cats – they can do it, but they’d really rather not’. So the brain automatically deploys System 1, using pre-tested behaviours or habits, namely what we did the last time we were in the same or a similar situation, which is very efficient and requires no input from the conscious brain. However, often we don't have experience of a similar situation to draw upon and this is where errors can creep in. In situations when we don't have a solution, the subconscious brain is not put off and will come up with an answer it borrows from elsewhere as a proxy. We're inclined to substitute difficult questions that we have no answer for, with easier ones that we do, rarely noticing the difference, as the left side of the brain, subconsciously spotting the gap, conjures a logical post-rationalisation for our response.

As you will have guessed, the drawback of the fast, instinctual System 1 response is that it is quite often wrong and the outcome of being wrong can be wasteful and suboptimal at best and in today's world plain dangerous at worst. Nonetheless, because it is automatic and outside our conscious accessibility, we still use our inherited or learned System 1 a lot of the time. We are more likely to use it when we face uncertainty, or the sheer volume of data or choices overwhelms our decision-making processes. While we call these automatic or shorthand responses of System 1 our instincts and rules of thumb, behavioural science calls them heuristics and the errors that result from them, our biases.

What is more, we can subconsciously recognise heuristics in each other. Taking Kahneman's example, an experienced motorist driving a car, does so in normal situations largely automatically. This only changes when the situation becomes atypical, such as when overtaking another vehicle. At this point, they switch from unthinking, unconscious routines to active-thinking, conscious ones. If they had been talking to a passenger (who is also a driver) up to this point, both will unconsciously initiate a silence, recognising the extra cognition required to complete the manoeuvre. The fact that the passenger also falls silent at this time and recognises the need for the driver to exercise increased care, reflects the commonality of the learned, driving heuristic. And if you doubt the automatic nature

of everyday driving, there is a test you can do on an experienced motorist – ask a driver to sit in a chair and simulate they are driving a car. Then ask them to pretend to change lanes as if they were on the highway, they will likely go through mirror, signal, manoeuvre and turn the imaginary wheel, right or left and then return it to the 12 o'clock position. The only thing is that if they were in a real vehicle they would have gone off the side of the road – if you want to stay in your new lane, you must make an additional and equal correction in the opposite direction to the number of initial left or right turns. If you simply turn the wheel right or left and straighten it to 12 o'clock, you only made a right or left turn.

System 1 or fast thinking is incredibly useful for the most part and only becomes problematic when it causes us to react instinctively when we should take more care to evaluate our options. When you see a world-class golfer, for example, they have learned and embedded their swing so well that when they play a shot, it has become entirely automatic - their swing has through practice become a System 1 activity they can theoretically repeat ad infinitum. Similarly, in our automatic responses, we are hardwired to spot indicators of suitability and openness to mate with a potential partner – lustrous, full hair is attractive because it signals health (apparently this is why *blondes have more fun* – they tend to be of a paler complexion less able to conceal illness), while we unconsciously notice an open mouth and dilated pupils as signs of attraction and possible invitation.

Amusingly, in the 2011 movie ‘Limitless’, the hero Edward Morra (Bradley Cooper) is given a drug called NZT-48 that gives him the ability to use his brain *fully*. Armed with a basic understanding of the System 1/System 2 dynamic, we can quickly see that this scenario is pure science fiction. NZT-48 permits Morra to use the slow, deliberate, analytical, reasoned power of System 2 at System 1 speed...or the other way round, so that his System 1 benefits from perfect information, free of the biases built up over years of lived experience and millennia of encoded human evolution (that for good reason we are prevented from accessing), to make that speed possible. It is not a question of brain capacity, more one of its very nature.

Some of our biases are potentially very useful to the would-be hospitality professional, so it is important to be aware of them. For example, where we are uncertain of the merits of a potential purchase, we are prone to be guided by its marked value – a higher price suggests higher quality. Similarly, when something takes longer to acquire or takes more effort, it implies quality – think of drawing a cork from a bottle. Research suggests that it is not the cork itself that implies quality, it is the time and effort required to draw it from the bottle and pour the wine that does this. There are probably fancy restaurants where the maître d' still performs the elaborate task of preparing *crepes suzette* on a gueridon trolley at the side of the guest table. They flambé off the Cointreau in a flourish of flame before serving. Yes, the aromatic smells permeate across the room, but it is as

much the performance that means that once you've sold one serving, you'll likely sell ten more. Similarly, people mistakenly think that having an open kitchen is all about demonstrating cleanliness and freshness of ingredients to customers, when in fact, it is just as much about the performance and so signalling quality through effort.

Effort or perceived effort are therefore important. Another bias not to be ignored, is that of social proof. Social proof is what is triggered when we see other people doing something, especially when there is uncertainty, and take the group behaviour as a guide of what we should do. This can be simply practical – in the post-communist era of the Soviet Union the saying went, *the first thing you do when you see a queue is join it, the second thing you do is ask what it is for*. In times when there are no shortages, we would still rather join the line outside a busy restaurant, waiting for a table, than walk straight in and be seated immediately in the quiet one next door. It is worth remembering that testing has demonstrated that it is more effective to sell a dish, drink, activity or room as being *the most popular* than the *best*. To demonstrate there is a difference between social proof and the effort-related biases, I give you the story of the retired locksmith. At the beginning of his career, it took him time and multiple attempts to get into a locked car or house and yet the relieved owners were so delighted they would settle the account and often leave a gratuity as well. Over the years, as he became more competent and efficient at letting people back into their homes or vehicles, the locksmith found people became correspondingly less willing to pay his fees and the tips dried up too – he was so good at it, that rather recognising his experience and skill, people just thought it looked easy and so were not getting value for money. Beware therefore of consultants who want to look clever and make things look hard.

If we go deeper on pricing and presentation, it is worth noting that evidence suggests we put the menu item we most want to sell in a prominent location at the top right corner, ideally in a standout font or text box; this apparently is naturally where the eye glances first on the page (in left to right, top to bottom reading cultures, at any rate). Further, one might play the *framing bias* – the first thing we see frames whatever comes next. So, when you list beers on a list, for example, if you present the most expensive first, it will make the others look cheaper. Show the cheapest first and you will make the others look expensive, and (referring back) of lower quality.

A research team at Cornell University determined that if you remove the dollar or currency sign from the prices on a menu, it detaches the monetary significance of the amount – making people not see it as *real money* and therefore less resistant to making the purchase. Then there's *extremeness aversion*. People tend to avoid the extremes when making choices, particularly the older they get (when they also tend to become more risk-averse generally). For example, if you offer a choice of three glass sizes (small, medium or large) when serving wine, most guests will

choose the middle option – at one *extreme*, the small glass (despite being first), might seem stingy or cheap, while the large at the other extreme might seem overly extravagant, so they plump for the medium. Where only two choices exist, the introduction of a super or premium offer can be used to drive your consumers into what has now become the middle choice, instead of the entry-level option. You will, I'm sure have noticed this with software as a service package, where you get a budget, starter or freelance package with limited functionality for one user. Next is the *professional* offering with more functionality (and possibly for more users – typically a meaningless added benefit), and then comes a premium, bells and whistles *enterprise* option (that appears aimed at large corporates – although I suspect their in-house tech teams do not buy groupwide software over the internet). The enterprise package is there to help you choose the *professional* package.

Taking things a little further, your choice of words and the order in which you present them will also have a telling effect. The order is important for framing as mentioned, but also it seems the first one or two words are the easiest to remember – by the time we get to the fourth or fifth words in a list or sentence our brains have generally reached cognitive overload and just zone them out. Play this scenario in your head if you don't believe it: someone is described as being:

intelligent, humorous, lazy and occasionally cheats at cards

vs

a card cheat, lazy, humorous and intelligent.

Which one would you hire first? This type of bias can combine with the *halo effect*, which occurs when we bestow unseen positive attributes upon someone or something based on a distinct positive trait that we can observe. Good-looking people may find that people will think they are more intelligent, successful or talented purely because they look good. There is an opposite version of this too, called the horns effect, whereby a negative characteristic causes us to bestow other negative traits upon a situation. There is a possibly apocryphal story that goes: *an airline executive told his team, 'if a passenger opens their meal table to find it coffee-stained and dirty, it tells that passenger that we don't do our engine maintenance properly'*. Whether true or not, it makes the point. To really confuse you, however, there is another bias that sounds slightly contradictory and should not be muddled with the horns effect – the pratfall effect (for non-US readers, a *pratfall* is to fall onto one's buttocks, or make an embarrassing mistake). Provided you are perceived as generally competent in the first place, the pratfall effect provides some comfort for you in those moments when you'd normally die of embarrassment or at least cringe. At the end of an interview (that was actually a social psychology experiment), a competent candidate knocks over a cup of coffee (spilling it over the table and themselves). The *unfortunate* interviewee (a plant by the psychologists) demonstrated

the required proficiencies for the *job*, as well as general capability during the interview. Because they had established this base-level competency, when they made the pratfall, it somehow made them more human and approachable – they had become more likable after making a mistake. I personally consider that the pratfall probably also triggers a care response in the interviewer, although I believe this particular aspect has yet to be tested.

It is clear that likeability confirms trust and a bond between individuals (and brands). We know it ourselves instinctively, if we like someone or think that they like us, we behave more positively towards them and vice-versa. Likeability equals trust (to a degree) and we need trust before we buy from a seller or make a friend. In another study by the research team at Cornell, they discovered that wait staff who touched customers (in the safe zone between elbow and shoulder) were seen as more approachable, created a stronger bond and were rewarded with higher tips accordingly. In sports psychology experiments, it turns out that teams that touch each other more win more. More generally, there are several ways in which we promote likeability, the most obvious two of which are humour and reciprocation. Think back to a time when you joined a number of other people in an unfamiliar environment. Many of us will start by simply observing the situation, evaluating potential threats and possible allies. After a while, someone will make a lighted-hearted remark to break the tension. Someone else gives an acknowledgement of the humour (even if it is very lame) and immediately a tiny bond is formed. They will then likely attempt a reciprocal gag, and so on as the new group begins to form. We can use humour (sparingly) to build relationships with each other and our customers – there are a multitude of adverts that spring to mind, where brands do this well. It is worth observing how much funnier things are when we enjoy them in company (tests have shown that we find things funniest when we are in groups of 3 to 6, which is why cinema adverts uses humour more than online adverts). If you think about canned laughter, used widely for sitcoms, remember that theatre impresarios have been planting laughing, crying and encouraging stooges in their audiences for centuries.

Equally, when bonding and trying to be likeable, we might be inclined to share some private information about ourselves or our situation with someone who is a relative stranger, who in turn will most probably share something back. There may be several things at play here, the initiator's desire to unburden to a stranger (there is little social cost of doing so compared to revealing all to a friend) and the receiver's desire to reciprocate and demonstrate that they're like us and confirm the fledgling bond. Reciprocation is an incredibly strong drive in humans and it has evolved as part of the cooperation tendency that has made us so successful as a species – if I share with you, because I know you will share back, it reduces the risk of doing so. It also reduces the freeloader problem (where someone obtains benefit from the group without contributing to it – it is the same as the *Free Rider* problem in economics), which is generally very destructive to any social society.

However, the desire to give back can leave us vulnerable to the brain hackers, so we should beware of people who offer us something for no apparent reason (cults often give something for free to get us on the hook). There is a sales technique, identified by Prof. Robert Cialdini in his book 'Influence: The Psychology of Persuasion', called *the door in the face* method. The door in the face uses reciprocity in a subtler manner – when exploring a purchase, the salesperson asks a ridiculous price for whatever it is (including charitable donations, mind!) and when you dismiss it in your understandable outrage, they counter with a much reduced price. This reduction is a concession and it's a gift aimed straight at you, and your inclination is to accept in order to reciprocate.

Professor Cialdini also identifies how another subconscious action – consistency or commitment bias – can be targeted by the skilled sales executive. This technique he refers to as the *foot in the door*, and involves starting the other way around from *the door in the face*, with a small ask that then gets followed up with a larger more significant ask. Such is our desire to be consistent for fear of looking like a lunatic (if someone says one thing and does another, or behaves inconsistently between actions, it reduces our trust in them) that we will do almost anything to prove how consistent we are so that we are not judged and labelled. In the original trials in the US, subjects were asked to put a large, objectively ugly, sign promoting road safety, on the front lawn of their house – virtually no one accepted. The trial was rerun and instead subjects were asked to place a small sticker promoting road safety in their front window, to which most agreed. However, it wasn't over then: two weeks later the testers returned and asked the subjects who had accepted the sticker whether they would now place the large, ugly sign on their front lawns – unbelievably, most accepted. The consistency bias can tug hard on our beliefs and understanding of who we even are – once we accept the initial offer, we become the sort of person that does that and then we act to remain consistent with that choice.

If you feel that's a bit of a reach, consider this situation: it's your birthday on 4 April and one year you decide to read your horoscope (someone once told you that you were an Aries so you're already partially invested). Curious, you read on beyond the musings for the day and learn what the astrologer considers to be the typical traits of an Aries – adventurous, bold, competitive, confident, determined, direct, energetic, optimistic, passionate and spontaneous. Throw in that *you're a Fire sign with a love of travel* and you decide the cap fits and you like that cap – you spontaneously and boldly book an adventure-sports holiday to Costa Rica, having never left the county in your life. All because of a consistency commitment bias. This goes some way to explaining the meaning behind the phrase *you will become what the most important person in your life wants you to be* (whilst a version of this is credited to leadership author John C. Maxwell, it's been around in folklore for centuries). So, you've booked the flight and are looking forward to a trip to Costa Rica, when strange things start happening – everywhere you look there are adverts

for Costa Rica and *quite by coincidence*, it seems everyone you meet these days is an adventure holiday nut. Some of this you put down to *cookies* (who now you think about it, might trying to tap into your bias). However, it is likely that another thing is at work here, this time it's confirmation bias.

The Baader-Meinhof phenomenon (or Frequency Illusion) is the tendency to notice a specific thing more often after you've just become aware of them. It is a combination of confirmation bias (the acquisition, interpretation, preference and recall of information to support prior beliefs) and selective attention or attentional bias (the effect of selective factors on your perception – such as a religious person considering that *God answers prayers* because they recall when prayers were answered, ignoring when they weren't). On a light-hearted level, you are probably familiar with the illusion of buying a new vehicle and then seeing it everywhere (*new car syndrome*); this phenomenon can just as easily apply when you make any purchase or even merely learn of a new concept.

From your own mental wellness perspective, it is worth considering that attentional bias can also be linked to anxiety and depression. Once you recall a bad memory, you suddenly recall many more. What's more, evolution has a hand in this as well – those who are more attuned to *bad* are more likely to anticipate *bad* things or read signals of imminent *bad* occurrences, and so avoid dying and being genetically cancelled. It is important to note that the initial recall of a *bad* instance can have little or no trigger, and this is likely to do with our problem-solving brains, with time on their hands, looking through past experiences for things to learn from or to *resolve*. It is worthing noting at this point that negative experiences tend to be almost twice as easy to recall than positive ones; sadly it's more likely we'll drag up bad memories than good ones. So having dredged up a detrimental moment from history to fix or handle better, attentional bias kicks in, providing us with an overwhelming surge of other similar events that might also fit the scenario. Suddenly, a glorious sunny day can appear bleak, a place that can be tough to dig yourself out of. I've found just talking out loud to a trained counsellor was enough to redirect my inner troubleshooter into diagnostic and repair modes. Mark Williams and Dr Danny Penman's 2011 best seller, *Mindfulness: A Practical Guide to Finding Peace in a Frantic World*, is also a good starting point for self-help.

With commitment and confirmation biases in mind and before we look at a final couple of human behaviours, we need to dip back into the power of descriptive words. When we use nouns and concrete language in copy, rather than verbs and abstract notions, it allows our audience to imagine themselves using the product or being in the scenario – *be a big mountain skier*, as opposed to *feel the buzz of skiing*. Incidentally, this is a surefire way of telling if you've got fake reviews on your site – few nouns and lots of verbs (fakers are not speaking from experience, so imagine using facilities rather than describing the features). Another thing to

note on copy writing and in marketing generally, we are evolutionarily disposed to notice and remember difference – we should remember this when promoting our businesses and do our best to stand out. There is a theory that suggests that water tastes of nothing, because we need to quickly recognise that the clear liquid we observe is not water after all, or is tainted by a potential pathogen.

Evolution has a lot to do with our inherited tendencies. Consider the shoal defence mechanism: a hunter chases fish or a herd of cattle, the targets of which unconsciously dart this way and that, close enough to each other to remain as a group, but sufficiently spaced to present a dizzying multitude of individuals. The quarry group works on the basis that they create confusion, confusion that requires hard work to resolve, too much work when the predator is also expending energy in the chase itself. We need to keep this in mind too, and limit the range of products we're offering our clients. A large range of choices can have the same effect of overwhelming customers especially if they are not familiar with our range (which creates conditions of uncertainty), with the result that they go for the base or default proposition rather than that which is best suited to them, or worse, they don't buy at all. For years, even fine dining restaurants have limited the number of starters and main courses to three or five offerings each for this very reason (as well as limiting the amount of stock they must hold and wastage from excess preparation of less popular dishes).

At this point, we will wrap up our exploration of the human psyche with a trip into group behaviours via the workings of the brain. For this we can turn to David Eagleman (professor of neuroscience at Stanford University and author of 'Incognito: The Secret Lives of the Brain'), who highlights that most of what we call reality is anything but, and instead is largely a subconscious hallucination constructed by our brains, often using incomplete information. Eagleman makes this point with specific reference to our sight, which is really multiple bytes of live data combined with our previous experience translated by the brain into the image we *see* – not necessarily what is actually there. He provides multiple examples of how this works in practice, emphasising the processing and learning power of the brain, illustrated poignantly in the story of Erik Weihenmayer, the first blind climber to summit Everest, who uses his tongue via a BrainPort to *see* the rock face in front of him. The BrainPort consists of a tiny video camera attached by a band to his forehead, working in harmony with a plastic tab populated with electrodes that he holds in his mouth. The BrainPort camera shoots images of the rock face in a 400 monochrome pixel resolution grid, which is then transmitted to a corresponding 400 electrode grid on the plastic tab, being *projected* on to his tongue via tiny electric shocks. The shocks increase in intensity with the increasing darkness of pixels, with the result that Weihenmayer's brain has over time learned to see '*pictures being painted with tiny bubbles*'. In addition to the remarkable achievement of this remarkable man and his team, tests conducted on people showed the cells of the brain associated with base-level ocular sight light

up when they are asked to *merely* visualise a certain situation in their mind – as if they were actually seeing it in real life.

The final example of Eagleman's hallucination proposition to share, is the story of a blind man, who had his sight restored later in life through revolutionary surgery. Journalists gathered to take photos of the moment when the bandages came off and the man was able to see his wife and children for the first time, only to be presented with his expression of utter bewilderment. The man had not yet *learned* to see – he was hastily trying to make sense of the image he saw with his newly healed eyes and the image he had created in his mind years before. It took several months for him to label and associate in a way that individuals born with sight take for granted. Once educated, the left side of the cerebral cortex can very quickly paint a picture (using our senses, especially vision, and imagination) and label the items in it. The left side of the brain can and regularly does subconsciously interpret situations we experience and post-rationalise our subsequent decisions in order to make them seem rational and considered...even if these outputs are largely made up and inaccurate. It turns out that we often delude ourselves and so do not truly know ourselves, which is not helped by the fact that we do not have conscious access to the parts of the brain that do this. This is neatly summarised by Jonathan Haidt, a social psychologist at New York University, as '*The conscious brain thinks it is the Oval Office but in reality it is the press office*' – hurriedly creating explanations for decisions that were made elsewhere in the brain (this ties in very much with the *cognitive blindness* created by the brain mentioned in 'Drawing on the Right Side of the Brain' at the beginning of this book). Again, this may be an evolutionary advantage – if we could know in advance which way we would leap when running to escape a predator, we might exhibit a *tell* that gave our intention away to our pursuer, ultimately ending our contribution to the gene pool. Similarly, our ability to deceive ourselves is necessary if we are to deceive others, whether that is via outright fraud or white lies which allow us to coexist in a socially acceptable manner: on this latter point, consider living in the movie 'The Invention of Lying' (2009), which imagines an alternate universe in which lying does not exist. The takeaway of human *delusion* is that contrary to what we might think, we often do not need a *reason* to trigger a behaviour; rather, a behaviour can trigger a post-rationalised reason for why we did what we did.

Professor Eagleman suggests that we have an innate ability to learn and lay down new behaviours that can in time and through repetition become unconscious. Further, it is his hypothesis that our complement of unconscious behaviours becomes a series of competing, rival routines, each vying to be the routine of choice in resolving questions in the most efficient manner. Where conflicts between routines of equal power appear, the conscious brain steps in and mediates between them. The rivalry could also be vital to maintaining our own mental health in older age. There are examples of people who in life had shown few symptoms of Alzheimer's disease, yet whose brains, examined after death, had

shown extensive damage caused by the disease. These people were avid puzzle solvers, crossworders and individuals who kept on learning and figuring out different ways to crack problems. As the posthumous examinations showed, far from building mental health and disease-fighting resistance, they simply had developed multiple alternative neuropathways. The brain simply rerouted connections down these pathways when infected areas of the brain ceased to operate correctly. We could do a lot worse than keeping mentally active and challenging our brains to solve problems in both logical and illogical ways. If you will indulge the sidebar, Eagleman extends his theory to a possible way to determine the sentience of beings – their ability to overcome equal and competing routines. In his example, rats were presented with a tempting treat and an electric shock at the same location at the end of a dead-end in a maze. This created a conflict between subconscious urges – the urge to eat the treat, balanced by the urge not to get shocked. The rats instinctively stopped at a distance from the stimuli where the power of each urge was equal and opposite, unable to consciously mediate between the two urges. In the future it may be possible to develop a grading system that scores the ability of a creature's brain to mediate between unconscious routines and thereby give an indication of its sentience. For example, is fishing cruel or not? A possible way to tell would be to measure the degree of conflict between the discomfort of pulling against the angler's hook and the desire to avoid capture.

The reason for highlighting these biases is to make the point that learning is part of the natural processes of both the conscious and the subconscious brain. While the conscious brain views and informs your perception of your world, it can just as easily make stuff up to post-rationalise behaviours that were actually driven by the subconscious. We should be aware of the tendency to use our System 1 heuristics and double-check our reactions to stimuli with our analytical System 2, verifying whether our reactions are the optimal or rational ones, rather than what we tell ourselves to justify acts.

Ok, before we move on to communications and because we are an inherently and fundamentally social species (that owes much of its success to that social nature), we will wrap up group behaviour. We have already discussed why people wish to signal membership of a group, now we'll look at a few other elements of the group dynamic. To kick us off, we return to our friend Professor Cialdini, and his fourth principle of influence – *social proof*. Social proof is why we will happily stand in line outside a busy restaurant, rather than going into the one next door that has every table still empty. We take our cues from the wisdom of the herd. If everyone else is doing it then so should we. If you are promoting a dish or a bedroom, you may well be better off suggesting that it is your *most popular* rather than your *best*.

The restaurant example is a good one, but equally important to consider is the problem of the equal and opposite – negative social proof. This is when people

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have undesired, but popular behaviours brought to their attention and then mimic them. In tests, Cialdini placed a number of signs in a US national park, famed for its petrified forest, to discourage theft of tokens of the fossilised trees. Those signs that highlighted the extent of theft seemingly encouraged even greater volumes of larceny, while those that emphasised that the majority of people didn't steal, reduced the instance significantly. I humbly suggest, therefore, that you definitely do not advertise that *only two people chose the clams* on your menu if you want to shift it before it goes out of date. This whole social proof concept is of course different from promoting the exclusivity of a product because it is only available to a limited few due to scarcity or price. Possibly unsurprisingly, it seems we are contradictory by nature and are drawn either to things that lots of other people like or that lots of other people would like, but that we and precious few others can actually have. Creating scarcity in combination with price/quality signalling can be a useful sales tool; just know that not everyone will be able to play the game and so your marketing efforts should be very specific and targeted.

Next, as part of our review of group behaviours, we will have a quick second look at confirmation bias – you remember, the one where you keep noticing that there are many more of your type of car on the road than before you bought it. This side to confirmation bias has greater implications in life and explains why politicians bang on the way they do, sometimes to the point that they sound a bit thick when they patently aren't.

Political affiliation is a good area in which to consider confirmation bias, although it occurs in any group setting and is subject to a number of other factors. In studies, questionnaire respondents were asked what they thought of a number of policies presented by government and the opposition. Those who supported the governing party thought the policies were worth supporting when they believed they were proposed by the government. However, when they thought the same policies were the invention of the opposition, they were violently opposed to them. When a politician from outside the group we affiliate with, is reported to have done something nefarious, it *confirms what we always thought about them and their kind*. Sadly, we are not inclined to look for evidence that this has been misreported or that contradicts our world view. Instead, this information merely serves to prove what we always thought.

Now add to this something known as the Unity Principle (which we've touched on previously although not by name) – that humans by nature, need or like to be included in groups, belong to something and share a common identity with others. These shared identities can significantly impact an individual's behaviour, particularly if the group conducts reinforcing behaviours. People are more inclined to say *yes* to or be influenced by people who share the same identity. First-hand evidence for this comes not only from political groups, but from the fans of sports teams to people who share the same birthday as you (you automatically

think someone is a *good sort* like you, just because you were born on the same day, and not necessarily even in the same year or decade). Unity can be easily used in marketing to groups, where appreciation of the group and its members can be a powerful tool (especially through membership-linked benefits, like giving access to special benefits, content or discounts). Lastly, consider homophily, which while closely aligned with confirmation bias and unity principle, may begin even earlier in the social group-forming process. Homophily, is the notion of *birds of a feather flock together*, or to put it another way, the tendency of people to form relationships with people who are similar to themselves. This was originally separated into two types: status and value homophily, where status is either ascribed by society (age, ethnicity, race or sex) or acquired (behaviours, education, occupation or religion), and value is simply association on the basis of attitudes, beliefs and values (this is regardless of and transcends status). Homophily explains why some subgroups are more cohesive than the wider group, why information can spread more quickly in the subgroup and why segregation and polarization can occur (this is typified in immigrant populations who gather together to create a support network that the wider group is not party to). Unfortunately, homophily and unity principle can turn particularly nasty when they exist in competitive settings. In early tests, children at a summer camp were grouped into teams on the basis of homophily generating characteristics. The teams were then pitched against each other in games, sports and events over the course of the summer. Within a relatively short period, the study descended into Golding-esque *Lord of the Flies* chaos, tantamount to warfare. Thankfully, the testers, realising the monster they had created, set about repairing the situation, at which point they discovered that creating *common purpose* between teams forged unity more strongly than the division of competition.

To put this into a hospitality context, a business guest in the hotel bar or an outsider visiting the local pub may have multiple reasons for being there, to gather local insights, forget about their day or just for company. While they maybe a stranger, they do have location and timing in common (that convey all sorts of implied similarities). In addition, a shrewd or seasoned interloper may well ask the bartender or the nearest bystander *what's good to drink* and then order whatever is suggested. In this scenario, a group may or may not form. If it does, it will most likely only form briefly for the evening, before dispersing and possibly reconvening in a slightly different guise the next day. Either way, individuals are prone to exhibiting all the normal characteristics one might expect of a more established or permanent group. For this reason, it is my opinion that this is why employing the right front of house staff is so crucial to success. As an old mentor once said to me, staff-up with the people you want to attract – he was wiser than he knew. The personalities of your team are vital too – the bar person, as a fixture of the location, can act in an alpha context, as the ruler of the space, or at least an authority figure or anchor for anyone that drifts in to the space and becomes part of the newly formed in-group. The team member has the power to invite any

guest to join the conversation and thereby the in-group, conveying membership and belonging.

A socially well-adapted member of staff can make the world of difference to your business and this is why you should recognise them as a person, with a name and identity of their own (you should also make them as approachable as possible). This is why I rail against stuffy, pompous, out-dated hospitality establishments that consider that it's *just not the done thing* to have staff wear name badges – they're people too and you want the best from them for your guests' sake. It is important to be indifferent to self-important snobbery. In the US, service is bright, jolly and transactional (you give me the service and I'll give you a tip). In Europe, service is more often than not a profession, to be studied and executed with the utmost skill. In England, we're often either hopelessly overfamiliar (people paying a gazillion pounds per night, do not want to be called *mate*), or stuck in Downton Abbey, unable to distinguish between good service, and servitude or servility – time to evolve, I feel. Just to mention, I always found service in the Antipodes to be the perfect blend of British formality and American *get up and go* – something to aspire to maybe?

## Communications

SKIP THIS SECTION, NOW!

How did it feel to read that statement? Affronted, I'd wager. It might have grabbed your attention, but it broke your flow and interrupted your concentration. What's more, I suspect you had a bit of a *don't tell me what to do* reaction to it? If so, you probably exhibited *reactance* bias – when an individual feels that their freedom of choice is being restricted, they react and reassert their independence. Skip this section now, feels like an instruction and we don't like being told what to do. Maybe a more familiar experience of this begins during our childhood development. After we are born, we reach a point (usually at around 18–24 months) when we discover that we are not just extensions of our parents, but distinct creations in our own right. Once we have this realisation, we play around with it and test the fences to learn the extent of our powers of independence – more commonly known as *the terrible twos*. This can take place anywhere from 1–3 years old and is marked by defiant behaviours (biting, breaking things, persistence, and saying *no* for the sake of it), mood swings, stubbornness and tantrums (amongst others). By the time we're 7 or 8, we've pretty much got the picture and understood the rules. Then between 9–12 years old, our peer group begins to take precedence over the influence of our family in our lives and we start to try and assert our independence in their direction (which is when, if all goes well, we develop self-confidence). When we hit puberty, we enact the final step in our development as discrete adult entities (which is why teenagers can sometimes be seen as not listening, being reckless or contrary). The reason for labouring the point

is that while you might think a sign at your business, or banner on your website that says *Buy Now to Avoid Disappointment!* is a call to action (that triggers loss aversion – we don't like to feel losses), it might actually be seen by your customer as a challenge to their freedom to make their own choice. Possibly strangely, the more a customer is aware of your brand, the greater the chance the message will trigger *reactance* (greater awareness of your brand increases the authority of your brand and therefore the greater the feeling of being told what to do). So, I start the section on *Communication* inviting you to consider how you can interact with your customers without SHOUTING AT THEM!

Quick tip – in life, in copy, in everything, be very careful with your use of the word '*but*'. *But* is mostly used to introduce a contrasting statement with what has already been said. However, in a psychological sense, *but* says *nothing you heard before the 'but' is true*. It is also a very negative word that breaks flow and concentration (no, I don't always listen to my own advice – I should on this).

Communication is possibly as important as everything else that we've looked at so far. It is, after all, how you get your ideas out there, engage with others and even yourself. According to Tom Hoobyar in 'NLP: The Essential Guide', '*The quality of our lives is determined by the quality of our communications. How we communicate with ourselves creates our personal experience and how we communicate with others determines how we are treated throughout our lives*'. In other words, the better our communication skills, the higher the quality of our relationships, personal fulfilment and overall life experience. Clear and open communication is essential for building strong, trusting relationships and allows us to clearly express our needs and concerns, leading to better problem-solving and conflict resolution. What's more, positive communication can enhance our emotional well-being and reduce stress by fostering connection and understanding, plus good communication skills are vital for collaboration, leadership, and career advancement. So it seems it's important! For me the essential product of quality communications is fostering empathy, and empathy is fundamental in business and life.

Going forwards, I therefore encourage you to take these ideas to help you build a platform of empathy in all of your communications. While empathy is narrowly defined as '*the ability to understand and share the feelings of another*', I add the broader meaning of being able to put yourself into someone else's shoes. Empathy is fundamental to effective communications and essential, therefore, in business. Good communication is vital. Dictionaries will somewhat dryly refer to it as the *exchange of information*, yet it is so much more, it's the very essence of our society. Indeed, the word communication is derived from the Latin verb *communicare*, 'to share', and sharing is at our very foundations, the basis for cooperation, culture, and organisation, and the essential component of community, our very society and social order. Incidentally, if you were struck by the similarity between the words communication and community, the latter actually derives from *communis*

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and in turn *communitas*, the Latin for *common* (which in the right context in modern English means *shared*).

Allow me to hop on my soapbox and bang on a little more about the importance of communication. Consider that even before we inform our potential customers of our revolutionary products and services, we must first, understand their needs and aspirations – we must receive that information from them. Further, without the two-way *exchange of information*, we will develop offerings that people don't need or want, and equally people will remain oblivious to our potentially life-changing innovations. Following the logic, if people don't know about these new products and services, they cannot make use of them and will therefore likely keep doing things the same way they always did. Progress and even the future, therefore, becomes reliant on good communication. On a human level, how successful can you be if you limit yourself to your own experience or avoid putting yourself in the shoes of your customers, co-workers and even your competitors.

### Techniques for Mastering Communications

In a nutshell, good communication relies on mastering the following:

1. **Active listening** – this is about engagement: asking questions and rephrasing what you've heard to confirm understanding. Check any preformed assumptions you have at the door, this is your chance to gather situational intelligence.
2. **Clarity** – brevity: being accurate and concise.
3. **Confidence** – conveying confidence: research, draft, redraft, rehearse to make sure you appear confident in what you're saying, particularly if you're prone to shyness.
4. **Empathy** – understanding and sharing emotions of others: be friendly and sincere, imagine yourself in your audience's shoes. Read the room, speak when people are ready, settled and attentive, but more importantly, know when to shut up and listen to your colleagues or co-workers.
5. **Feedback** – is the essential part of communication that closes the loop: know how your points and words are being received. Don't take feedback personally, use it as an opportunity to improve, and don't be personal when you give feedback to others.
6. **Non-verbal communication** – about 90% of communication is non-verbal, from facial expression, hand gestures and stance that you can control, to micro expressions and chemical cues that you cannot. Being open will help make your controllable actions relatable, while being honest will help your

authenticity with the uncontrollable ones. As a side bar, science demonstrates that mirroring the behaviour of the person you're speaking with helps to build trust, and responding speedily to requests helps you look more efficient.

Now to learn the real power of words and observe the mastery of leadership communications, who does it better than a sect? Jody Raynsford's 'How To Start A Cult' provides an insightful and practical treatise on developing belonging and attracting devotees to your brand, using methodologies gleaned from some of the most effective cults (but only for good, of course). I will quickly summarise, but it is no substitute for reading the book – if it's your kind of thing, you'll be through it and using its wisdom in no time.

1. **Controversial Message** – Jody starts with not trying to be all things to all people. You're better to have 500 followers who actually follow and engage with your brand than 10,000 who just clicked *Follow*. To do this, he recommends developing a polarising message, one that divides opinion. Most importantly, however, it's got to separate the sheep from the goats. The potential devoted followers from the rest. The message should be clear about what you're about, what the benefits of your *cult* are ...and most of all, it needs to be compelling. To an extent, this is similar to the way a *horse whisperer* works – they stand in the middle of the training ring and at first, completely ignore the horse they wish to break in. The horse circles around and around, backwards and forwards, observing the whisperer and waiting for the challenge to their independence (it thinks *my defences are up and I'm ready to do battle with you*). The whisperer stays calm and doesn't play, they don't acknowledge the horse or even look at it. This becomes intriguing to the horse and after a while, its curiosity gets the better of it and it comes to the whisperer, not the other way around, and by this time such is its curiosity that it is docile enough to begin being trained (curiosity is a very neutral and calming emotion in humans too, sometimes used to help people with impulse control issues).
2. **Find Your Enemy** – this was something I initially struggled with because it sounds negative, but actually it isn't quite what you think. When you pick a fight with your nemesis, you are identifying a common foe for your *cult* to stand up to or oppose, and thereby create a common cause that you all stand for. It also means you identify what you're *not* and champion your team's counter point against whatever that is. While you could identify a person or company as the Mr Hyde to your Dr Jekyll, I feel more comfortable imagining attitudes, behaviours or beliefs that jar with what I consider I stand for (considering what we're looking at in this chapter, it's rather coincidental that Robert Louis Stevenson was somewhat obsessed with human personality and its influence on good and evil behaviour).

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3. **Be Different** – be different in your cult culture to demonstrate contrast between your offering, *what you are* and everyone else (before you start trying to join the dots, the word *cult*, denoting *homage paid to a divinity* is derived from the Latin *cultus* meaning *worship*, while culture comes from the Latin *cultura* meaning *growing or cultivation*). Not only does *different* help you stand out, it helps build stronger internal bonds too.
4. **Repetition** – as with all marketing efforts, repetition is key – think *cultus* and how the message is repeated and reinforced in weekly visits to the church or temple. The other important component to repetition is choosing your single, preferred medium of communication and sticking to it. If you start using multiple different channels, your followers won't know where to find you to stay up-to-date or interact. Plus, you'll be in danger of spreading your message too thin to be effective. Where will you be that is your natural habitat and fits with your style? LinkedIn, Facebook, YouTube, a podcast? You decide, but choose something that you can keep doing, often without it being a chore.
5. **Find Your Lost Sheep** – targeting people who don't fit in with the mainstream is easier than aiming at those who do. Mavericks who don't have a tribe present a greater opportunity, compared to conventional folk who gain stability and comfort from their herd. Give them a chance to belong.
6. **Reinforce Belonging** – help people to feel they're part of something, our thing. This links strongly with something we will look at in Project Concept, but there are couple of fundamental rules for this: tell stories (it's how we understand the world), remind people of what you're about, make them feel special, reward their loyalty, involve them, and encourage them to evangelise for you.
7. **Demonstrate Membership** – cults across time and around the world have developed salutes (or less creepy greetings), rituals and lexicons that allow followers to signal their membership. Build simple, easy to do rituals into your offering to get the same confirmation and reinforcement.

*How to Start a Cult* is wonderfully light-hearted and humorous guide (with some adult language), but the key takeaway is, develop and sell *belonging*, rather than putting your emphasis on the *creed* behind it.

Great – our look at communications gently drifted into branding, and brand is what we'll look at in greater detail next. Before we do, however, I would like to ask you to consider everything we've looked at so far in this chapter, particularly Maslow's Hierarchy of Needs, and to do this from the perspective of *feeling*. Why do this? My grand reveal – '*The essence of great hospitality is creating safe space for all*'. When people feel safe, they are more able to relax and be who they want to be. A safe space will mean different things to different people, at different times, depending on their purpose and mental state in the moment. A safe space might

be physiological – a physically safe location, with an elevated position, strong walls and security barriers, or it might be psychologically safe, where someone is made to feel welcome, or part of a community. Equally, a safe space might be a group environment that reflects their status, or even self-actualisation and the realisation of their potential.

### Branding & Building Emotional Connection

Why do companies bother with branding? A simple internet search will tell you *it's a business strategy that helps a company create a unique identity and stand out from competitors*. A better definition might include something about *occupying space in the minds of your consumers*, but for me, the truth is about forming a connection with your customers that earns their loyalty. Create a personal bond and your guests will compare you less on the price or attributes of your offering, and more on how close they feel to you. A brand should to all intents and purposes be a personality, a living, breathing thing.

Now if you broadly accept this proposition (which is the one promulgated by most branding geeks), we need to revisit Carl Jung, the former colleague and friend of Sigmund Freud, until they fell out in 1913 (primarily because Jung wouldn't accept Freud's obsession with sex as the main human motivation, and Freud wouldn't accept Jung's notion of the *collective unconscious*). Like Freud, Jung considered the human psyche to consist of three components, but in his world these were the ego, the personal unconscious and the collective unconscious. Together, these elements, including universal *archetypes* (and personality types) and *individuation (the process of becoming a distinct, independent person with a sense of self and purpose)*, form the basis of Jungian Theory of Personality (closely linked to the Myers-Briggs Type Indicators, which we'll discuss later).

Jung considered the ego to fundamentally be the conscious mind, with all its thoughts and memories we are aware of, while he considered the unconscious mind to be divided into two layers. These layers amount to the personal unconscious, the feelings and memories that we are not aware of, and the collective unconscious, which are inherited universal threads common to all human societies that we are only aware of through our feelings and dreams (commonly expressed in culture, including art, literature and religion). Jung suggested these instincts, behaviours and characteristics are handed down through evolution, as ancestral memories (such as an innate fear of spiders) that he termed archetypes. Jung was clear these archetypes were not inherited ideas, but experiences and patterns of behaviour. The archetypal characters most commonly cited in brand work are to a degree those found in the 12 Olympians of Greek mythology:

1. Aphrodite (the Lover),
2. Apollo (the Creator),

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3. Aries (the Warrior),
4. Artemis (the Seeker),
5. Athena (the Sage),
6. Demeter (the Innocent),
7. Dionysus (the Magician),
8. Hephaestus (the Orphan),
9. Hera (the Caregiver),
10. Hermes (the Jester),
11. Poseidon (the Destroyer),
12. Zeus (the Ruler).

In addition, archetypes from mythology include the notion of the Femme Fatale, the Great Mother/Empress and the Trickster, and interestingly, there are strong links to the Major Arcana of tarot. In a simplistic sense, the archetypes are merely inherited representations of basic human desires, truths and folklore, but because they are universal, we can all relate to them in our subconscious. Some archetypes are more familiar to us and will possibly reflect who we are, who we would like to be, or who we present to the world. Equally, we will see the patterns in our friends, public figures or brands, as we recognise the archetypal characteristics through the back stories we associate with those behaviours. If you are struggling to feel how archetypes work, think of the films we watch; they all possess an archetypal theme and a storyline that has likely appeared from and recurs in mythology (that is consistent across cultures). You might recognise these as: Apocalypse, Creation, Coming of Age, Great Battles or Floods, Good vs Evil, Heaven/Paradise, Hell/Underworld, Overcoming Adversity, Virgin Birth and Rebirth. As an example, think about the 'Lord of the Rings' movie trilogy: a flawed hobbit (the innocent or undeveloped hero/anti-hero), is sent on a journey (to grow and defeat evil), bestowed with a special gift from a wise, mysterious old man (the magician) with ancient knowledge (the sage) and ultimately, whilst suffering injury, overcomes the shadow (the lesser desired characteristics) in himself to be reborn as a true hero. Along the way he picks up friends (the everyman), support from kings (the ruler) and relief (the caregiver), etc. You might see archetypes in the groups to which you belong or belonged – the class clown (the jester), the arty one (the creator), the team captain (the ruler), the one that always gets the girl or boy (the lover), and so on.

The archetypes are important for branding because when correctly aligned, they allow your brand to become a person that others can relate to. And to be truly

relatable, a brand needs to truly be a personality of its own – with opinions, loves, fears, motivations and so on. None of us relates to all people, but we do relate to some more than others and when we have the choice, we gravitate towards these people. To wit, it is better to align with a single archetype than several – think about your own relationships; we shy away from people who are ambiguous because they are not consistent in their behaviour. In the same way, if a brand is inconsistent, it appears to not know itself, and becomes a confused proposition. Our brand should have a personality that our target customers easily associate themselves with or aspire to. Select an archetype that best reflects that of your audience or a certain desire within them. Get the alignment right and you will create a stronger connection with your customers, which in turn allows you to move away from simple price and benefit comparisons. Additionally, because we remember things told to us in stories better than as chunks of raw data, aligning with an archetype (with the inherited, evocative back stories already imprinted in our minds) will make our brand more memorable for our target audience. Considering around 95% of our purchase decisions come from our subconscious, emotional connection (and memorability that we are unaware of) is crucial to our success – we want customers to instinctively choose us ahead of everyone else.

Today these archetypes are still largely grouped into 12 leading types, refined into four groupings (three of each linked with instinctive, base human desires). In developing the personality of our brand, we should look at the voice, the message, the loves and fears of the different archetypes in order to find the best one to associate it with:

### EXPLORING SPIRITUALITY

The **Innocent** (Safety): honest, humble | be decent and pure | simple, moral vs opaque, deceitful;

The **Sage** (Understanding): reassuring, wise | stay curious, keep learning | expertise, intelligence vs chaotic, foolish;

The **Explorer** (Freedom): daring, fearless | get out there and experience it | adventure, excitement vs restriction, caution;

### LEAVING LEGACY

The **Outlaw** (Liberation): disruptive, rebellious | challenge the status quo | change, independence vs conformity, subservience;

The **Magician** (Power): belief, hidden knowledge | enact your vision | discovery, transformation vs doubt, uncertainty;

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The **Hero** (Mastery): courageous, upstanding | achieve your goals | perseverance, succeed vs cowardice, failure;

### PROVIDING STRUCTURE

The **Creator** (Innovation): imaginative, innovative | see the potential | originality, self-expression vs typical, stagnation;

The **Ruler** (Control): dominance, strength | set the standard, achieve it | success, status vs failure, insignificance;

The **Caregiver** (Service): caring, reassuring | look after each other | comfort, support vs indifference, neglect;

### PURSUING CONNECTION

The **Everyman** (Belonging): friendly, real | get on with each other | equality, fellowship vs hostility, isolation;

The **Jester** (Enjoyment): fun, humorous | one life, live it | happiness, positivity vs boredom, negativity;

The **Lover** (Intimacy): sensual, sexy | look at me | affection, indulgence vs loneliness, rejection.

As discussed, it is better to settle on a single archetype that fits with you and your customers' outlook on life, than to offer a confused image that is vague or unclear. However, certain archetypes can become typecast in certain sectors; think medical products or services and the Caregiver, and so it is necessary to differentiate your brand in different ways. You can either be an atypical archetype for your segment, which needs to be done carefully (a certain sneaker company tried unsuccessfully to be the Explorer, when its core values better reflected the Caregiver), or you can use an archetype mix. In which case, you might use a mix of two-thirds core archetype and one third influencer archetype – the core is strict to your values, while the influencer is your differentiator. It is probably best not to dilute the core more than this or you risk appearing confused. Don't forget that the aim is to give your brand a personality that is relatable to your audience and is consistent with your values, thereby you will create that sense of belonging and safety we have looked at previously. Consider how you might describe yourself as a personality, what your outlook on life is, what is important to you, what you like and what you dislike, what interests you and what bores you, then do the same for your brand and relate it to your target audience. Once you have identified your archetype, it is time to put flesh on the bones and give it a full, real life personality. To do this, it may be helpful to imagine the story behind the

personality, where they have come from, what has been their journey, what were their moments of joy or the disappointments – how did they feel and how did they respond? What is their intended end destination or the pathway through life they choose?

Similarly, you can look at their world through all of their senses, imagine how we all observe and interpret the world – predominantly through images and sounds, obviously, but it does no harm to think of the smells you like or wish to associate with (e.g. machinery or green meadows?), the tastes (crisp white wine or rich chocolate?) and how things feel in a tactile sense (a warm blanket vs linen shirt?) or even what quality of paper you will use – heavy weight or recycled?). If you do this correctly from the start, you will automatically create an authentic character for your brand that knows who it is, what it stands for and who its friends are. It will also know what its purpose is, why it exists and how it is going to make a difference in the world. Some brand aficionados will get into a fervour over the order you work on your brand architecture. I suggest getting in a room with a large whiteboard and just working through the following all at once: Core Messaging, Expression, Identity, Mission, Personality, Positioning, Purpose, Tone of Voice, Values and Vision.

With the brand personality and story as a foundation, you can now look at developing the brand identity and awareness. You'll have noticed that it has taken until here to even get close to exploring brand name, tagline, logo design, typeset, colours and brand experience. This is because these all flow from the underpinning elements of brand personality, promise and voice – it's about getting the horse and the cart in the right order. Now that we've covered the underpinnings, we can look at these other important components of branding, all of which should go into a style guide and brand book/bible (that can be shared with designers and team members so you can achieve consistency across all your brand touchpoints).

**Name:** ideally eye-catching and easy to recall, but must speak to the brand personality;

**Logo design:** something that is instantly recognisable and that captures the essence of the brand character;

**Slogan (tagline):** clever and catchy (old school rhyme and alliteration still work, but are not essential), think back to our investigation of how guests might visualise doing the activity or using your product;

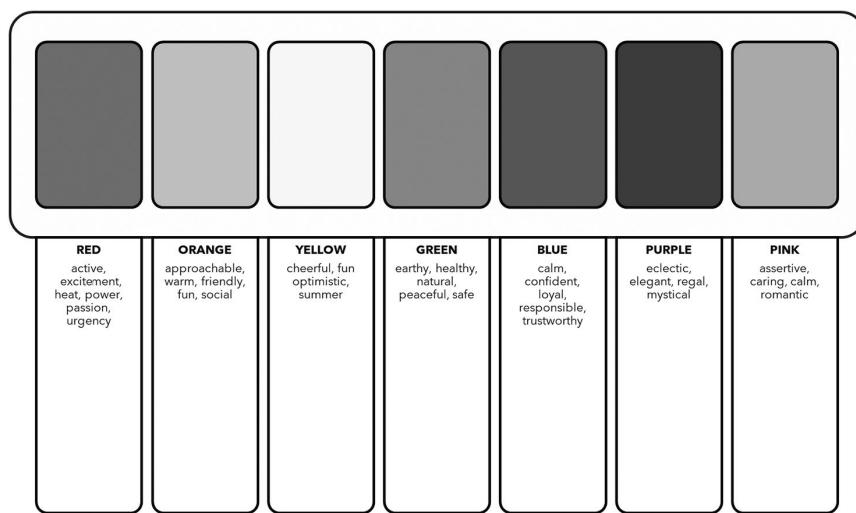
**Colours:** different colours evoke different emotions and are relevant in different settings (bright, primary colours might be ok in a fast food joint where you want to evoke energy and speed, but less so in a fine dining restaurant where you expect them to stay for several hours). Note that in a restaurant, neon colours can be overwhelming in the same way as primaries, while blue and purple can feel cold and uncomfortable because in nature, food sources with

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these colours are rarer and can hint at inedibility – we’re aiming at creating a safe space, after all. The image below summarises some colour/emotion combinations, but for food settings consider:

- **Black:** created using lighting of colour can give focal points and a sense of intimacy;
- **Brown:** can be relaxing;
- **Gold:** and other precious metals signal luxury;
- **Green:** especially rich dark greens can emit notions of sophistication and elegance;
- **Orange:** can make a space feel warm and stimulate happiness;
- **Red:** curiously red often stimulates appetite and increases table turnover;
- **White:** will generally make the space feel larger and cleaner, but also more impersonal;
- **Yellow:** implies excitement/energy and can make people more chatty.

Additionally, it is worth remembering that shades (contain more black in the colour) are darker, while tints are lighter (contain more white in the colour) and the use of either can impact how a colour is perceived. Additionally, patterns can



**Figure 4.2** The different feelings associated with different colours

have positive and negative effects and so should be used carefully. As a rule, try not to use more than two or three main colours (maybe on walls or carpets), with one or two additional accent colours as flourishes to bring flare to design (e.g. with furniture and cushions).

**Typeset:** important to reflect the brand character: is it whimsical or clean and modern? As a tip, it can be useful to have a complicated or sophisticated font for your brand name and then a cleaner easier to read font for the tagline and following copy – it can help the brand name pop;

**Imagery:** think about what images you will want to use that will evoke your guests' sense of doing or being with you (reminder: be careful where you get your images from and make sure you have the correct permission to use them);

**Sounds:** do you want or need a jingle? Might you need the sound of gently breaking waves on your Caribbean retreat website? Will your background music remind your customers of the prevailing trend of their twenties, or be empowering, belter-ballads about life after love?

**Touch and Taste:** How will everything your customers touch evoke the essence of your brand? Do you want guests to snuggle in for a while (soft comfortable furniture) or eat and leave (hard durable plastics)? For years, luxury hotels have used marble on front desks, which is the first thing the customer touches (given that the bell-person opens the front door for them) – a design feature that indicates *this place is quality* (German car manufacturers learnt this early on too, with the tactile feel of the door handle and solid clunk of the closing mechanism); What tastes will you wish to evoke through your imagery, or what food and drink will you serve at your launch? It all says something about your business, and should speak to customer and brand values (it might be confusing to serve imported champagne at a remote eco-retreat in the jungle, when a locally made therapeutic fruit smoothie would work).

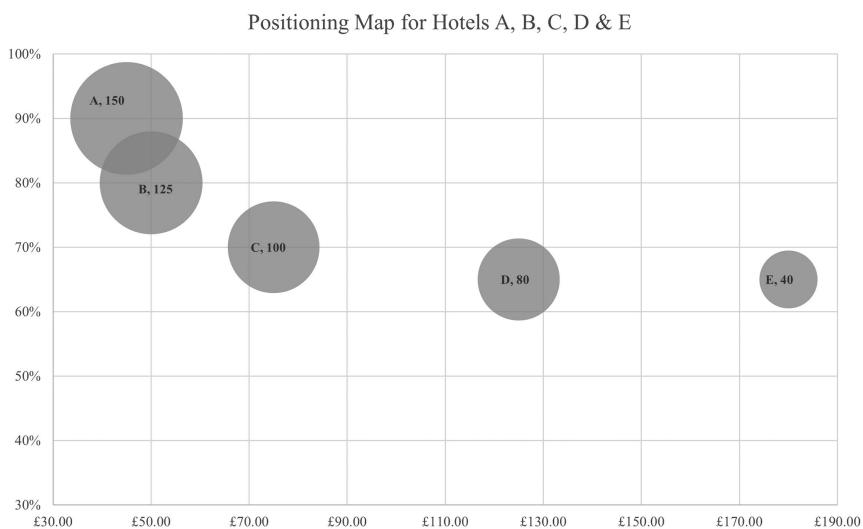
A checklist for all of this might look something like:

- 1) Establish the brand core values;
- 2) Flesh out the personality traits and origin story;
- 3) Feed in all of your customer and market research (including developing your customer personas);
- 4) Get into the design elements (colours, logo, etc.).
- 5) Develop out the positioning and messaging (coming up next).

## Extending Your Brand into Sales & Marketing

This is fundamentally about brand *positioning* and messaging, and is part of your marketing strategy (that in turn feeds into your sales plan and tactics). This is the crossover moment where all your work on your brand combines with its target audience, where your brand meets its public. The aim is to develop the brand image or identity, using all the elements mentioned before, and integrate the value proposition (the benefits of your offering vs your competition) in order to connect with and stand out in the minds of your customers ahead of your competitors. This might sound like a bit of a retrograde step now that we know about the power of brand archetypes, but it does in fact build upon that rather than replacing it. In developing your brand positioning (most simply put, as the place your brand occupies in the minds of your customers), it is important to consider your target audience, their needs, preferences and aversions, the key characteristics of your unique value proposition (or unique selling point – USP), and your competitors. For hotels, I have seen marketers develop positioning maps like the one below.

The Figure 4.3 diagram is not particularly scientific and reflects an approximate illustration of volume vs value, with the size of hotel shown by the size of the bubble, the volume of business (rooms sold in occupancy %) against the value (or price charged in average room rate terms in £s). Businesses sometimes do this just to see where their offering sits in terms of quality of the offer against the average daily room rate in comparison to the wider market, or in order to see where potential gaps in the market might exist. Note, however, that the second reason is



**Figure 4.3** Bubble chart showing the volume vs value positioning of different-sized hotels in a competitive market

highly nuanced and should not be taken out of the context of the local conditions. To explain, the graph suggests there is gap in the mid-volume/mid-value area between C & D – namely, for an average-sized hotel, say 99 bedrooms, achieving average occupancy of 74%, at an average daily room rate of £95. If such a hotel existed in this market and it hit these numbers, it would theoretically achieve the highest revenue per room of all. However, that would rely on a large proportion of statistically average customers, who probably do not exist in reality. Research suggests people are either satisfied with cheap prices for widely available functional offerings, or are thrilled by value-added offerings with limited availability, especially if the high prices indicate exclusivity. Beware the middle ground that stimulates neither reaction, and especially beware of averages!

When evaluating your customers it can be helpful to segment them into different categories (we have looked at this previously) and specifically tailor your positioning to each. This is often done by developing the personas of the typical guest in the categories. Then when you've done that, you can work on your USP(s) and it is wise to select these carefully – they must be unique. If they are truly unique and you can get guests to understand this and they value them, they will likely choose you over your competitors because of their loss aversion – they will not want to go somewhere else that doesn't have what you offer because they will lose out. Loss aversion comes back to the work of Daniel Kahneman and Amos Tversky in their paper on Prospect Theory, in which they demonstrated (amongst other things) that we register loss twice as hard as we feel an equivalent and corresponding gain. In other words, the emotional hurt of losing \$5 is twice as intense as winning \$5. This is why you might see a casino handing out \$10 of free chips to entice you inside, because they know that once you have accepted the chips (they become yours: an endowment), you will bet with them, and due to the odds will likely lose, at which point you will put your hand in your pocket and bet your own money to win your money back – you can't stand the loss. Similarly, with stocks and shares, people will sell rising stocks and hang on to falling stocks in the hope that they will come good because they don't want to crystallise their loss.

So now that we've identified our customer needs and matched them with our unique value propositions, we can position our product in the minds of our consumers by segment. This is then fed into their minds through messaging designed to highlight all of this and is deployed through the marketing mix. The point of introducing brand into your marketing activity is to use your brand identity to influence your customers' perceptions, gain their trust and ultimately increase sales. We will look at how to write a marketing plan in the coming chapters, but for now it is useful to know two things:

- i) How to incorporate brand into your sales and marketing, as discussed above;
- ii) How to use the marketing mix, a set of components the company can use to meet the needs of its customers, aka the 4Ps of:

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- a. Product – the tangible and intangible offering, including its branding, quality level and features;
- b. Price – not what it costs the company to make, but what the customer is prepared to pay, and which can also be used as a positioning tool;
- c. Place – this is not where your business is located, but instead where you place information about your business, which channels you use to get your offering in front of its target audience (channels might include content marketing, email, search engine optimised website, social media, TV); and
- d. Promotion – refers to types of activities you undertake to increase awareness of your offering and promote its value (including advertising, PR, sales promotions, social media campaigns, etc.).

Since the 1980s and the arrival of the 4Ps, additional Ps have been included (sometimes 7, sometimes 8), but these bonus Ps tend to be variations of parts of the existing Ps and merely reflect shifts in emphasis.

In summary, though, to see if you're on track, make sure you can answer the following questions:

- 1 What are our brand promises?
- 2 What are our USPs?
- 3 What solution(s) do we provide?
- 4 Who are our customers?
- 5 Is it all coherent and can we make it more concise?

From this level of strategic thinking, we'll move on to my favourite, more broad-brush strategic approach to hospitality.

### Strategic Thinking

It is worth noting that although strategy and tactics are used interchangeably in common language, they actually refer to different things in business. A strategy is the overall action plan for you to achieve your goals, to get you from A to B. Tactics, by contrast are the individual actions or steps you take on the way. In other words, if a strategy is the plan, the tactics are the things you do to implement that plan. Most importantly, the platform for a good strategy is always to be found in the best available information at any given time. With good data, you can conduct meaningful analysis of logical, conscious behaviours, but make sure you also factor in the sometimes less logical unconscious patterns too. Do be selective in the data you use and ensure it is as current and valid as possible, just

don't pick your data to suit your intuition on a situation. Avoid the computer science acronym ...garbage in, garbage out, or GIGO. Situations and the availability of information can be fluid, so it is always worth revisiting data sources regularly and particularly when something changes. Good analysis of information (including the hidden psychological factors at work) in turn forms the basis for good decision-making. In short, your aim should be to collect relevant information and process it to allow you to fully comprehend your situation and predict what might happen next. In doing so, you will be able to identify the knowable hazards or opportunities that require mitigation or action to take advantage of them. In doing this, you are aiming to develop situational awareness, i.e. an awareness of the key factors influencing an environment and how it changes over time. This approach is widely adopted by emergency services and the military today, but finds its roots in Sun Tzu's 5<sup>th</sup> century BC treatise '*The Art of War*', which despite its 13 chapters, is still a relatively short and worthwhile read on strategy if you have the time.

If you intend to develop a hospitality business, it is vital to have a strategy and a picture of the whole play in your mind from the outset: 360 degrees, beginning to end. Why are you doing this? What does success look like? What does your exit look like? As the famous author, motivational speaker and salesman, Hilary 'Zig' Ziglar put it, '*If you aim at nothing, you'll hit it every time.*' One of my mentors saw the sense in setting targets for the team, five per cent above where he wanted to end up, recognising that people frequently underestimate the effort required to hit them or how far they can go when stretched. The importance of having this overall vision is particularly true if you're to avoid making errors early on in the process that come back to bite you. There is an adage in the property world that states that the price you pay is the one variable you can't affect later on – if you over-pay for your real estate, you're stuck with that fact (and all the knock-on effects). I advise looking at your end goal(s) and working backwards to your today. Only once you have a plan, can you figure out how to execute it, and you can only plan with sufficient, relevant, quality intelligence (the product of good data and good analysis). Information is best gathered by questioning, and like Rudyard Kipling:

*I keep six honest serving-men,*

*(They taught me all I knew);*

*Their names are What and Why and When,*

*And How and Where and Who.*

*I send them over land and sea,*

*I send them east and west;*

*But after they have worked for me,*

*I give them all a rest...*

(The Elephant's Child, Rudyard Kipling, 1902)

Remind yourself that your strategy must include the fourth dimension of time.

There is another skill that is very hard but very useful to develop, what I call the *eagle's eye*. It is my version of critical thinking, where I try my utmost to deploy unabashed rationality and remove my conscious prejudices and be alert to my subconscious biases – personal objectivity is the key to good strategy. The eagle's eye approach is exactly the approach adopted by eagles in the wild. Eagles have both acute depth perception and excellent panoramic sight that they use to identify prey and are some of the most successful hunters in the animal world. It's little wonder then, that bald eagles are revered and associated with understanding, vision and power in Native American cultures. Bald and Golden eagles, have eyes approximately the same size as our own, yet see up to eight times better and can clearly identify prey at two to three miles away. Like humans, eagles have eyes with a lens that focuses the image onto a retina packed full of cone photoreceptors (cells that detect light and colour, giving spatial acuity). These cones are concentrated in the fovea, a central depression on the surface of the retina, which for eagles is like a deep dish where the cones are incredibly densely packed. In humans the fovea is much shallower and is only able to hold around 200,000 photoreceptors per millimetre. This compares to one million per millimetre in an eagle, and what is more, eagles have two fovea in each eye. The eagle's central fovea gives incredible sharpness and clarity, while the lateral one affords exceptional long distance sight. This is why an eagle can fly high above the surface, constantly scanning for prospects and danger, while simultaneously closely inspecting anything that catches their attention. I would like you to figuratively do the same – keep your eye on the horizon and search for opportunities and threats, while at the same time zooming in on the details of anything that looks significant. In other words, have an umbrella plan, but don't lose sight of the key indicators that will alert you to situational changes beneath your nose. Copy the eagle, use focus and commitment, planning and action, and a developed strategy.

Armed with the eagle's eye, we can get stuck into the body of what I consider to be the best strategic thinking method, as developed by the USAF's Colonel John Boyd in the late 1970s and early 1980s. Colonel Boyd developed what is known as the OODA Loop (observe, orient, decide, act), a concept for rapid decision-making in combat operations. The scenarios for which he designed the OODA Loop were typically matters of life or death, where decisions were required in split seconds. I trust that your circumstances are not half as intense as these, but rest assured, the same technique is applied today in non-combat situations by emergency responders, critical incident teams, lawyers, corporate managers and cybersecurity professionals, across the world. Somewhat surprisingly, it has even been successfully used in political campaigning.

The power of the OODA Loop lies in maintaining superior situational awareness and applying it to gain advantage. The key is assessing situations better and faster

than your opponents. As a potential start-up in a sector dominated by big firms and brands, I suggest it might be relevant to you.

There has been a lot of discussion about the OODA Loop and there are people who wish to diminish its usefulness by taking it very literally, making it much more complicated than it needs to be. I still consider it to be an easy-to-use, useful and effective means of strategizing. In simple terms, OODA starts with the gathering of information, which is analysed, and thereby converted into useable intelligence, to give rise to a series of options and then action. I first came across this methodology in John Braddock's book 'A Spy's Guide to Thinking + Strategy', under a slightly different guise that he referred to as a DADA loop (data, analysis, decision & action). John's example is that of being on a moving train, when he was approached by someone who appeared to be a druggie. He had to decide quickly whether this person represented a threat and if so, what sort of threat. He couldn't immediately tell whether this person was a counter-intelligence agent working for the other side or simply a drugged-up mugger on a train. The two scenarios would require radically different responses, each of which would be wholly inappropriate if his judgement and choice were wrong – go pre-emptively on the offensive and risk beating up an otherwise innocent druggie, risking personal injury and blowing his cover, or do nothing and risk being taken off the intelligence board by a nefarious enemy operative who would take attacker's advantage? This is the starting decision that precedes action. In the end, and without giving it all away, more information came to light during the intelligence gathering stages of his looping that meant no action was required.

Scientists don't start by immersing themselves in mountains of broad-ranging information and then hope a eureka moment will come out of the blue. They start with a hypothesis and then go looking in specific data sources where the answer may lie. They use the data to test the hypothesis – I think X is happening or Y will happen when I mix A with B, what does the evidence say? If we wish to use the DADA routine, we should do the same. We want to end up with options, each of which we test against its underlying hypothesis. A storm is coming through, we have the option to do various grades of something (depending on our analysis of severity), or nothing if we don't believe it will hit at all. We then go to the data: high wind speeds, are they increasing, what is the current trajectory of the storm, is it changing or is it stable, what about other factors that might influence it? What is the likely outcome? What is the likelihood or confidence interval? Then, if the storm does happen, what is the potential impact? How can we respond before and after the event? Don't start with data, start by estimating what you think will happen, what your opponent is after, what is their objective or endgame, how do you think someone will behave or respond – what is your hypothesis?

In business, your opponent might be literal, a competitor who is conducting their own DADA loop. If you can read them correctly and feign one course of action

while actually doing another, it might give you an advantage, which is known as getting inside their loop. If your opposition is human, you need to get to their motivation quickly as this informs your hypothesis. You might think this is impossible at first, but there are shortcuts that can help. First, you can ascertain your opponent's perspective, what sort of game are they playing, what sort of scenario is this? There are only three types, zero-sum game (someone must lose for someone else to win – they gain market share and you lose it), positive-sum (you share information voluntarily with the other side to help both parties grow the market together, which can continue as long as it serves both sides), and negative-sum (where both sides lose, like a labour dispute, when both parties are incurring losses until one decides they can no longer continue and withdraws). In reality, the options usually reduce to just two options, conflict (zero-sum) or co-operation (positive-sum). Zero-sum games are nearly always fought over people, places or things with the winner taking a person, a place or something from the loser. Positive-sum games are different in that they tend to be focused on what people fight (or are in conflict) over, and therefore will be fought over all three elements (people, places and things). So ask yourself, am I in a competitive or cooperative situation? You determine which scenario you're in and look forward to the other side's endgame: what are they trying to achieve? – a great vacation or to take market share.

The reason for making this assessment is to try to determine the way in which our opponents think and therefore the game we're playing. For you, that might simply be, should I go ahead and launch my hospitality business? It will cost a lot of time and resources, but equally importantly, commitment to action will limit my ability to do something else (certainly for the time being). Do you think it is a positive-sum game? If you launch, will people come to you and buy your offering? Will it be worth the effort and expense? Go back to the specific relevant data and test it. Your DADA loop then looks like the one shown in Figure 4.4.

While your customers have their own DADA loop that starts with Decision ('try the new restaurant'), then back to the Data ('any good TripAdvisor reviews?', 'what's this going to cost me?'), then Analysis, Decision ('try/don't try it') and Action ('try it'). The two combine in a positive-sum game.

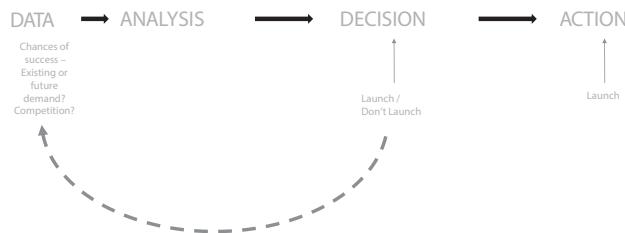


Figure 4.4 The DADA Loop in use

At the end of the day, strategy is about looking forwards and trying to predict what will happen. But to do this well, we actually need to think backwards from the future to now. Things in the future will largely happen for a reason. Getting to the reason is crucial because if we know the reason or motivation for someone to do things, the better we can predict them. Working backwards, you might start by imagining a customer staying at your guest house in the future. You reason backwards to establish why they could be there, when they could be there, how they could get there and so on. Then you can build a strategy to make sure you hit all of these dependencies to ensure that they *are* there at that future date. Work out why they might come, what is their motivation? Is it work or play? Is it a choice or because they have to be there? Will they be alone or with family? How can you best alert them to the existence of your guest house? When is the best time to do so? Is it a Sunday afternoon in September just after they are back from holidays and are planning next year's trip? How can you make it easier for them to book? Where do they live and how are they therefore likely to get to you? How can you make it easier? Keep asking the questions and reasoning backwards until you can build a strategy to make it happen, then take action and implement it. But keep looping through it, what is working, what isn't? The final component that we will consider is what happens when you are trying to predict how a group of people will behave – pick the boss (whether an individual or board) and try to predict what they will do...the rest will follow.

In business, the OODA or DADA Loops can be thought of in terms of getting a step ahead of the market and your competition, by accurately assessing both, spotting and reacting quickly to changes in either. In an increasingly competitive and dynamic world, good situational awareness and agility may be the difference between success and failure.

It may be preferable to be cautious, deliberate and thorough, making choices more slowly; however, the reality is that critical decisions often need to be taken most quickly, especially if you have an innovative idea and you want to be first to market it. Additionally, the search for perfection can cause significant procrastination and inhibit action:

*'Perfection is the enemy of progress'* (Winston Churchill, c.1906). It is important to prioritise action ahead of getting everything just so.

Over the years, I have heard people misquote or misuse the Pareto Principle or *law of the Vital Few* when referring to decision-making (*Pareto had noticed that approximately 80% of Italy's land was owned by 20% of the people...and it turned out that a similar distribution applied in other countries too*). On a broader front, what Pareto determined was that 80% of consequences are derived from 20% of causes, and it was this that gave rise to his 80/20 rule. In decision-making, this means choosing the 20% of tasks that will make a difference to 80% of outcomes. It is misapplied

when people interpret it as, *you can make a decision with 80% of the information*. If you want to go down this road for a pithy rule of thumb, I'd go with the astute wisdom of Secretary (Colin) Powell, who operated the 40/70 rule – you need 40 to 70 per cent of the total information to make a decision. If you have less than 40% you don't have enough information to make the decision, and if you wait to get more than 70% of the information it will take too long, by which time the moment will have passed and the decision will be made for you. In the end, we all aim to make the best decisions as often as we can, and we should try to make more correct decisions than incorrect ones. However, we must not be so afraid of making mistakes that we fail to make decisions at all – the balance of perfection vs speed. You just need to make the best decision you can with the information at hand, within the 40/70 rule, and remember this when you look back at a decision with 20/20 hindsight. In time, your ability to accurately get to the crux of a matter or make a decision with less than perfect information will get easier, as you immerse yourself in the world of your project. At this point, beware of becoming so attuned to the environment that you rely on your judgement rather than objective facts and causality. Amazingly, Violet Jessop was aboard and survived the wreck or sinkings of the Titanic, Britannic and Olympic ships – it would be easy to suggest she was either very lucky or unlucky, but absurd to suggest her presence at any of the events was causal! We must be careful not to attribute causation where statistics might suggest it.

It is worth noting that in the real world, it is rare that you'll get anything like perfect information. Even proprietary empirical data can be misleading, particularly if taken out of context, so you have to apply logic in your sense checking and analysis. However, once we've applied our reasonableness tests, accept that the data may be imperfect and make the best decision you can at the time (just recognise when a situation has manifestly changed and adapt, going through the process again with the updated information). Regularly revisit the information and check for critical updates.

Before I finish this section, I should briefly mention that there are a number of other tools for aiding strategic thinking that follow similar methodologies to the OODA loop. Each has a slightly different emphasis and purpose, and may suit one situation ahead of another. I mention them here so you can explore them on your own:

**PDCA (Plan Do Check Act)** – Continually Improving, in a Methodical Way. Also known as PDSA (Plan Do Study Act), the 'Deming Wheel,' and 'Shewhart Cycle'. Imagine that your customer satisfaction score on a business ratings website has dipped. When you look at recent comments, you see that your customers are complaining about late delivery, and that products are being damaged in transit. So, you decide to run a small pilot project for a month, using a new supplier to deliver your products to a sample set of customers. And you're pleased to see

that the feedback is positive. As a result, you decide to use the new supplier for all your orders in the future. What you've just done is a single loop called the PDCA Cycle. This is an established tool for achieving continuous improvement in your business.

**BRAIN** (BRAN and BRAND: variations of the same thing) – an analysis of the decision by its Benefits, Risks, Alternatives and Intuition of the options. Medical professionals commonly use this model to help them to make informed decisions about their patients' outcomes.

**Kepner-Tregoe Matrix** – a problem-solving exercise that is focused on risk assessment: it begins with clarifying/defining the problem, analysing its causes, evaluating the possible solutions and associated risks, and finally selecting the best solution while making contingency plans in case things don't work out the way you expect. It is used widely by groups from GM to NASA.

### Behaviours and Personality Types

So, if good strategy and good communication are so vital, it follows that understanding your human resources and the different ways they prefer to give and receive information must also be extremely important.

Before we start down this line, it is the preferred method of communication that we are primarily interested in here, and much less the personality types people believe they are, adopt or aspire to. The reason for this clarification is that when you talk about personality types (bracketing *personality* into simplified groups), you get a sharp intake of breath from the psychiatry establishment, and for good reason...

According to Perugni et al (2016), 'the definition of personality is behaviour of an individual which is relatively constant over time and doesn't depend on context'.

Personality is merely a set of repeated behaviours, not the other way round. However, several contemporary texts have become widely popular precisely because they define personality *types*, bracketing behaviours into groupings that are derived from a personality type...and here the controversy begins. I am fortunate to be an expert in the business of hospitality, and while I have studied human behaviour in the real world and am familiar with the scientific method, I am not a psychiatrist. Therefore I can only proffer opinion based on study and refer to my own observations. Given these limitations, clinicians are correct to avoid over-simplification or the use of personality types to identify a *package* of behaviours, as this would be back to front. Think of a medical doctor, who looks at a patient's symptoms to identify a named condition – a diagnosis. The diagnosis is

simply a label for the collection of symptoms. It is highly unlikely that the label would give the patient those symptoms (possibly with the exception of some form of anxiety disorder). Imagine if, without an examination a doctor declares *Mr Smith, you have psoriasis*, whereupon the patient breaks out in hives. That said, I do think that personality types can be a useful way of labelling a certain group of behaviours in an easy-to-use and accessible way. In so doing, one is able to better understand how people who exhibit specific traits prefer to communicate, similar to the way doctors use prescribed medication to treat a condition. Dismissing the use of types out of hand or as *pseudoscience*, risks throwing the baby out with the bathwater and missing their point, albeit understandable on a professional level. Psychiatrists prescribe medicine, and are experienced in human biology, which they consider in their psychological evaluations. Psychologists are professionals who consider cognitive and social factors, the study of which has foundations in philosophy. Both take years of study and applied experience to achieve proficiency in, yet both can still sometimes be referred to as the pejorative *shrink*. ‘Shrink’ is the shortened idiom of *headshrinker*, a particularly gruesome, mystical and ancient practice of shrinking the heads of conquered enemies by removing the skull from inside the flesh, replacing it with a small block of wood and then boiling the head with herbs to a shrunken size. No wonder doctors wish to differentiate themselves.

The problem is that we, as managers are totally unqualified as mental health practitioners, and yet have to deal with people, at speed, in *live* non-clinical situations. We need rules of thumb to reach for in the moment. A full psychological evaluation is simply not within our skill-set, so it is not practical, possible or warranted to attempt one ourselves. We still have to ascertain how our teams and the individuals they’re composed of, will respond in different situations. We need to predict the behaviours and responses of both our co-workers and our customers, to help us communicate effectively, develop our situational empathy and foster connection. For any heuristics we use in this regard to be of value (as opposed to being in the hands of emeritus professors), they must be easily recalled and simply deployed. What is the use of wisdom stored in a book you left at home when you’re trying to get a colleague to understand why you think something is so important at the office? I have therefore tried to sift the gems from the canon of literature on the topic to give you some useable techniques to use. So with the disclaimer done and tin hat on, let’s get into the minefield of competing schools of personality type thought.

### **Personality types**

MBA courses and modern business literature refer to a wide range of personality types, from Myers-Briggs Type Indicator (MBTI) through Enneagram of Personality and DISC-based theory (popularised in Thomas Erikson’s ‘Surrounded by Idiots – The Four Types of Human Behaviour’). The following is a brief summary of those three:

### MBTI

Based in part on the work of Carl Jung, whom we met earlier, MBTI can be broken down to four questions, each with a corresponding type indicator which combine to give a four-letter descriptor. Responses reflect tendencies towards one end or the other on a scale for each question:

1. Is the subject outwardly (Extrovert) or inwardly (Introvert) focused?
2. How do they prefer to take in information? (focus on the facts = Sensing, or imagining concepts = iNtuition)
3. How do they prefer to make decisions? (using logic, Thinking or with empathy for others, Feeling)
4. How do they live their outer life? (Judging, by planning and knowing what you're getting into, vs Perceiving situations, being spontaneous and inclined to improvise)

People using MBTI are grouped into the four letters in the order of the questions above: i) extrovert (E) or introvert (I), ii) intuition (N) or sensing (S), iii) feeling (F) or thinking (T), and iv) judging (J) or perceiving (P). To illustrate, my own MBTI profile is ENTJ or ENTP, the first three letters (extrovert, intuitive & thinking) suggest I'm energised by working with others, focused on solving problems with big-picture solutions based on the relevant facts. I am borderline J or P most of the time. This means that while I'm a fairly static ENT, I am much more fluid on planning and improvising – probably a result of working assignments in developing locations where information is imperfect and cannot be relied upon. As with anyone, all responses are likely to shift when we're subjected to stress or changes in external environment.

Some MBTI providers take the naming a step beyond the four letters to refer to personality type – apparently this makes me either a *Commander* (ENTJ) or a *Debater* (ENTP). My self-diagnosis for the variation in my type above, highlights the *type* assessment problem – personality type doesn't dictate behaviour, situations and behaviours determine personality. Another problem with this and other type methodologies, is one of ego or gaming the system. An example of the *Commander* would be Steve Jobs, while Dr Emmett Brown in 'Back to the Future' is the *Debater*. Which would I prefer to think of myself as or for the world to see me as? Dr Brown was highly intelligent, but nuts, while Steve Jobs was incredibly successful in business. Who do I fancy myself as? Maybe more relevant, which type is going to land me the role? Which sounds most like the job description? Consciously or not, it is possible I'll alter my answers to MBTI to be a better fit, no matter how many times an assessor says answer instinctively and honestly. Personality types might be useful in understanding how to talk to different people, but I suggest they have more limited value if used in the hiring process. And this gets time-poor human resource partners into a pickle – they need to filter

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the 250 *easy apply* resumés they received for the one role just this week, but the candidates try to game the system and there is a real risk of getting chaff when they wanted wheat. To quote the highly acclaimed *pseudoscientist* Mark LaMoure, ‘*You become like that, that you admire most. By admiring excellence and practicing, it can boost you to become excellent*’, otherwise known as *fake it ‘til you make it*.

If you relate to the MBTI system or variants thereof, you can find free tests online to build your own profile and evaluate your colleagues; just keep the limitations in mind. An internet search will also provide further detail on the characteristics of each four-letter combination and provide opportunity for endless conjecture.

### *Enneagram of Personality*

THIS SYSTEM IS similar to many of the available personality type tests in that it asks a series of questions and uses your answers to determine your type by number (1–9). It is a much longer test of 180 questions, so set aside some time if you choose this method. I should say that Enneagram has come in for significant criticism from psychology professionals for its lack of objectivity and the difficulty in testing it scientifically. As with other tests, it is important to point out that it is not designed to bestow a static personality type, but encourage us to adopt the better behaviours of each of the types and avoid the worst traits in our leading type indicator.

The Enneagram system is more complex to understand, with the nine personality types:

1. The **Reformer** – idealistic and principled.
2. The **Helper** – loves to please and thinks of others
3. The **Achiever** – determined and energetic
4. The **Individualist** – creative and rebellious
5. The **Investigator** – explorative and secretive
6. The **Loyalist** – earnest and consistent
7. The **Enthusiast** – multi-tasker and cheerful
8. The **Challenger** – self-confident and powerful
9. The **Peacemaker** – reassuring and serene

Each of these types is then given 11 behaviour or emotional identifiers:

1. Characteristic role (type name),
2. Ego fixation (mental preoccupation),

3. Holy idea (view of reality),
4. Trap (inhibiting behaviour),
5. Basic fear (demotivators),
6. Basic desire (motivators),
7. Temptation (excessive behaviour),
8. Vice /Passion (negative outcome),
9. Virtue (positive outcome),
10. Stress/Disintegration (scale 0–9) and
11. Security/Integration need (0–9).

For example, Type 7: The Enthusiast – **Ego Fixation**: Planning, **Holy Idea**: Work/Wisdom, **Trap**: Idealism, **Fear**: Being deprived, **Desire**: be satisfied, **Temptation**: grass is greener, **Vice**: Gluttony, **Virtue**: Sobriety, **Stress**: level 1, **Security**: level 5.

Type 7s therefore naturally plan and seek wisdom and contentment, but they need to be wary of not being too idealistic or thinking that fulfilment lies elsewhere. They should note how fear of being trapped could cause them to inhibit their performance and that they might be prone to over-indulging. They don't get particularly stressed and have a mid-range need for belonging and security. Otherwise considered '*The restless explorer, the one who's always going after whatever makes you feel alive. Like a Pandora box, nobody knows what's coming next. Spontaneous, versatile and highly stimulated...up to new intense things*'. You can see some overlaps with MBTI in terms of the thinking that goes on behind the questioning, but to my mind Enneagram is less useful at this point because of its unwieldiness, and it gets more complex the further you go into it...different types are grouped into *triads* (of three types), such as the 'centres of intelligence' triad – intellectual, emotional, and instinctual. While every individual will reportedly have all of the centres operating in their lives, their dominant personality type will give them a leaning towards one of these centres. In context, types 5, 6, & 7 are most associated with 'intellectual' behaviours (i.e. thinking), while types 2, 3, & 4 are more strongly linked to emotional behaviours (i.e. feeling). Types 8, 9, & 10 are most closely associated with 'instinct' behaviour (or gut reactions). The system gets more complicated still, with types presented in a circle with the nine personality type points oriented around its edge, in a truncated clockface (with nine at the top counting backwards in a counterclockwise direction). Within the circle, a triangular association is made between nine, six and three, as well as linking lines between the other numbers in groups of three...to be honest it is at this point that I give up. It becomes too complicated and cumbersome a model to use in the moment.

### DISC model

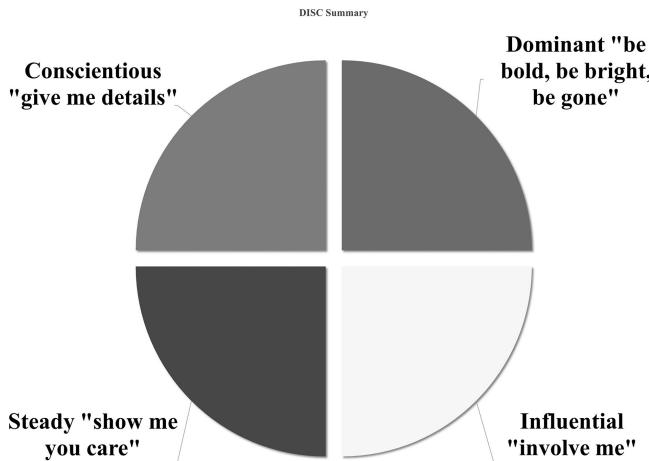
In contrast to Enneagram, Erikson's interpretation of a DISC model, is much easier to remember and use in live situations (possibly why he has sold over 10 million copies of 'Surrounded by Idiots' worldwide). You may have come across the DISC model at work as the 'Insights Test' (one of a number of people/human development companies offer their own version of DISC-based programmes, typically partnering with in-house HR departments). The DISC model seeks to explain behaviours by evaluating four traits: Dominance (D), Influence (I), Steadiness (S), and Conscientiousness (C), and give them easily relatable colours. It stems from the original work published in 1928 by psychologist William Moulton Marston, whose early DISC involved: dominance, inducement, submission, and compliance. Various self-assessment models were then developed by Walter Clarke (1956) and John Geier (1970s). These early versions centred on outgoing vs reserved characteristics combined with task- vs people-oriented behaviours. In the contemporary DISC, Ds (red) are on the outgoing/task side whereas Ss (green) are diametrically opposed, displaying reserved character and people-focused decision-making. Yellows (I) are on the people-focused side, but are more reserved, and blues (C) are reserved/task-oriented – not a million miles from elements of MBTI.

In Erikson's version (which is the most popular and current):

1. **Reds** are **Dominant**, whose communication style to others can be summarised as 'Be bold, be bright, be gone'. *Thought of as fiery, competitive, demanding, determined, strong-willed, purposeful and task-oriented.*
2. **Yellows** are **Influential**, summarised as 'Involve me'. *Sunshine, chatty Cathy, sociable, dynamic, demonstrative, enthusiastic and persuasive.*
3. **Greens** are **Steady**, summarised as 'Show me you care'. *Earthy and all about feelings and emotions, caring, encouraging, sharing, patient and relaxed.*
4. **Blues** are **Conscientious**, summary 'Give me details'. *Cool and analytical, cautious, precise, deliberate, questioning and formal.*

Reds and yellows are therefore generally considered more extrovert while greens and blues might be more introverted. Erikson, and other DISC practitioners do recognise that personality type behaviours can change under stress or in differing situations, and while the cool blues might normally be reserved, they can be the ones dancing on the tables at 4am after a drink or few.

Again, whether it's a DISC model or MBTI, any value lies in their ability to easily inform in the real world. As discussed at the beginning, mental health professionals steer clear of personality type groupings, preferring to use a diagnostic approach to the behaviours. For this they tend to use the five-factor model, which in many ways is not so vastly different in its assessment, with the direction of association being the fundamental contrast.



**Figure 4.5** Summary DISC Diagram, from left to right and top to bottom: blue, red, and green, yellow.

### Behaviours – The Five Factor Model

Clinicians refer to personality traits with the five-factor 'OCEAN' (or CANOE) model that explains behaviours under the headings of: Conscientiousness, Agreeableness, Neuroticism, Openness, and Extraversion. Against each of the five factors are a series of values that are attributed to them (as well as related words of description), and which combine to describe personality, temperament, and the psyche (the complete mind – both the conscious and unconscious). Under 'O', openness towards experience, we would find juxtaposed values of curiosities vs cautiousness. With 'C', conscientiousness, you would expect to have organised vs careless, while 'E', extraversion could be expressed as either energetic or reserved behaviour. 'A', agreeableness is categorised under the opposites of compassionate or rational (emotion or logic, friendly or critical), and finally 'N', neuroticism, as sensitive (nervous) vs resilient (confident). In practice, it may be useful to apply five statements (or variations) to the person you're trying to understand, such as:

O – 'I visualise things easily, or I don't have a good imagination'

C – 'I do my chores straight away, or I put things off'

E – 'I start conversations, or I stay in the background'

A – 'I feel your pain, or there's no use being all emotional'

N – 'I get irritated quickly, or I'm usually pretty chilled'

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As stated, the key difference between Five Factor Models (FFMs), as organised under the OCEAN/CANOE acronyms, and assessments like DISC, is that the former focuses on repeated human behaviours that dictate personality, while the latter focuses on personality types that dictate behaviour. Beyond this, the two opposing approaches view other matters differently, with FFMs considering underlying traits that aim to describe behaviour across situations, while the *type* models focus on behavioural styles in particular contexts, usually relating to communication and interaction. Whichever theory you subscribe to, the benefit in business comes from the improved empathy gained from stopping to think about how you listen to others and how someone else will receive what you are saying, as well as from being mindful of the manner in which you are both saying it.

Good communication is of paramount importance in business, with a different objective from providing therapy in a clinical psychology context (although *types* are sometimes used by talking therapists and other practitioners). Undoubtedly, certain individuals are more analytical in their approach to everyday life; they like to absorb information and process it before reaching a sometimes more dispassionate conclusion. Others are definitely less focused on the facts and are more interested in how they and others feel about a certain scenario. How you present the *scenario* to a particular individual will definitely have a bearing on their acceptance of it. In this sense, I find DISC-type analysis useful in the communication stakes, provided one is focused on the empathy side and always careful not to take the *type* groupings as permanent, static or absolute. It is important to be in the moment, pay attention, read the situation and adapt as necessary. You may want to consider whether the person you're interacting with is friendly and compassionate vs critical and rational. Are they a sensitive or nervous type vs a resilient/confident character? Do they talk about being inventive or curious, or are they more inclined to be steady or cautious, and finally, are they outgoing and energetic, or would they prefer to be in their own company? What you observe should help you develop empathy with the person you're speaking with and inform how you communicate accordingly. You may want to develop your own methodology and give it an accompanying acronym to make it easier to remember (I use mnemonics all the time), or you may want to borrow and adapt an existing one. My favourite approach is an unofficial one and possibly the shortest of all, gifted in amongst many other interesting and useful negotiation techniques by former hostage negotiator Chris Voss (as revealed in 'Never Split the Difference'). Chris highlights the importance of building rapport quickly in high pressure situations and so he boils the whole world down to just three types:

1. **Assertives** (what DISC practitioners might recognise as reds and yellows),
2. **Accommodators** (the warm greens) and the
3. **Analysts** (the cool blues).

In his humorous example, a silence or break in conversation will mean different things to each of the types: to the *analyst*, silence equals, *great, this gives me the time to process what I've just heard and form a response*; to the *accommodator*, silence means *oh dear, this is not going well – someone is angry and I'm not sure why*; and finally, the *assertive*, who takes it all in their stride and thinks, silence, *great, nobody is speaking, it's my moment to be in the limelight and speak!*

Either way, it will be helpful to have your heuristic, provided it is interactive and you don't rely blindly on it. With any of the approaches described, it is important to remember that if you want to be effective in your communication, you will find it easier if you adapt your own behaviours to make them compatible with how the listener or the receiver prefers to accept information. Use words, images and examples that they relate to and deliver them in a style that is comfortable for them.

Whichever methodology you choose to adopt as your shorthand, it is important to keep in mind their responses to what you say, when you say it and do your best to mirror the behaviours you witness. If someone speaks very quickly, don't hang about and deliver each word for effect, get to the point quickly. Similarly, if someone uses their hands a lot when expressing themselves, try and appeal to them on a visual level – maybe they'll get the point more quickly if you show them a picture or diagram.

In this context, if you're training someone to do something, be mindful that some people prefer to watch you demonstrate it first, while others prefer to read written instructions or to have the steps involved told to them one at a time, while others still have to learn by doing. While we're talking about teaching, it is important to realise that how you give feedback on someone's performance and progress can either crush them or catapult them forwards – it is all down to how you present your appraisal of their efforts. You will find it difficult or impossible to maintain engagement and participation if an individual loses confidence. One approach to help to provide criticism kindly, is the praise-burger, which follows the *compliment, critique, compliment* again (or positive feedback, negative or constructive feedback, positive feedback). Practice it, it does work.

### **Personality Disorders & Characters to Watch out For**

Aside from the types vs behaviours discourse, there are certain categories of individual you should always be alert to. While the debate on whether behaviours manifest personality or personality drives behaviour is a battle between psychiatrists and psychotherapists, the area of *personality disorder* can spark debate between professionals and patients. The issue is that as our understanding of mental health advances, so does the way in which we discuss it. Clinicians might argue that to refer to a particular diagnosis as an illness or *disorder* is unhelpful,

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giving a series of symptoms a label that once in place, is difficult to shift. This may be particularly true where these symptoms are the perfectly reasonable reaction to external stimuli encountered going through a tough life. On the other hand, some patients have stated that they find it tremendously helpful to label their diagnosis so that they can name their condition, understand their symptoms, and identify the best treatment. It is important to raise our awareness of mental health issues and to be aware of how you and the people around you are doing, by being observant of our individual behaviours.

If you repeatedly see or exhibit any of the symptoms below, beyond what might be called normal levels, you may wish to consult with psychology professionals. I am not suggesting you become an amateur psychiatrist, merely encouraging you to increase your awareness and be informed of the basics, which is just as well, as there are more than 30 *common* mental health problems: anger, anxiety (& panic attacks), bipolar disorder, body dysmorphic disorder (BDD), borderline personality disorder (BPD or emotionally unstable personality disorder), depression, dissociation & dissociative disorders, eating problems, hearing voices, hoarding, hypomania (or simply mania), loneliness, obsessive-compulsive disorder (OCD), panic attacks, paranoia, personality disorders (we'll look at these more closely in a moment), phobias, postnatal depression & perinatal mental health issues, post-traumatic stress disorder (PTSD), premenstrual dysphoric disorder (PMDD), psychosis, recreational drugs, alcohol & addiction, schizoaffective disorder, schizophrenia, seasonal affective disorder (SAD), self-esteem issues, self-harm, sleep problems, stress, suicidal feelings (& attempts), tardive dyskinesia, and trauma.

To simplify the long list of disorders, the charity Mind, groups the ten recognised personality disorders into three categories:

### 1. Suspicious Personality Disorders:

- a. *Paranoid* – suffering from paranoia (find it hard to trust or confide in other people),
- b. *Schizoid* – unlike schizophrenia or schizoaffective disorder, it doesn't typically manifest in psychotic symptoms, merely a desire to detach or be alone,
- c. *Schizotypal* – distorted thoughts or perceptions.

For reference:

**Schizophrenia** is a mental health condition related to *psychosis*. It can start suddenly, or develop over time, with symptoms that include a lack of interest or self-care, feeling disconnected, difficulty concentrating, avoidance, hallucinations (hearing voices or seeing things), delusions (strong beliefs that others don't

share, including paranoid delusions), disorganised thinking and speech. Sufferers, are unable to carry out normal daily functions, are likely to become upset, confused or suspicious of others (especially strangers, or authority figures) and disagree with people who think something is wrong. They are often afraid of seeking help.

**Schizoaffective Disorder**, is a mental health problem where you experience psychosis as well as mood symptoms (*schizo* refers to psychosis, while *affective* refers to mood). While it is a separate diagnosis, it has been suggested that it exists on a spectrum, between schizophrenia and bipolar disorder. Sufferers might struggle to look after themselves and show a lack of insight into their behaviour. It often begins in early adulthood. Similar to schizophrenia, *psychosis symptoms* include hallucinations, hearing voices and delusions (such as fearing people can hear your thoughts or that you have supernatural powers), as well as extreme disorientation, confusion, fear, a loss of interest in things, lack of emotional control or concentration. *Mood symptoms*, sometimes called episodes, are similar to those experienced in bipolar disorder and can include both manic and depressive symptoms (of extreme excitement or irritation, making irrational plans that put sufferers at risk, or feeling sad, low or suicidal). There are two types of schizoaffective disorder, *bipolar type* (manic episodes alongside symptoms of psychosis, sometimes accompanied by depressive episodes) and *depressive type* (only depressive episodes with symptoms of psychosis). It is hard to diagnose as patients may present very differently; however, it is worth noting that recreational drugs can also cause similar symptoms.

**Bipolar Disorder**, meaning changing between two completely opposite states, mainly affects mood with periods (episodes or states) of manic or hypomanic episodes (feeling high) or depressive episodes (feeling low), and potentially some psychotic symptoms during episodes.

**Psychosis** (aka a *psychotic experience* or *psychotic episode*) is when someone perceives reality in a significantly different way to those around them. Psychotic experiences vary between individuals and commonly include hallucinations, delusions and disorganised thinking and speech. Typically, psychosis refers to an experience and is a symptom of certain mental health problems rather than a diagnosis. Someone diagnosed with schizophrenia for example might well experience psychosis.

## 2. Emotional & Impulsive Personality Disorders:

- a. *Antisocial* – regularly acting impulsively out of anger or lack of consideration for others, not having empathy or seeing consequences, with diagnosis including symptoms that attribute violation and disregard for others' rights, particularly exhibiting the now redundant terms

of: *psychopath* (manipulative, unable to form relationships, dishonest & lacking remorse), and *sociopath* (unable to conform to social norms, lying, aggression & recklessness),

- b. *Borderline* – the most commonly diagnosed disorder, showing consistently unstable, intense or angry behaviour, and exhibiting abandonment fears, loneliness, binging (eating, drinking or drugs), suicide or self-harm tendencies (may result in paranoia, psychotic experiences and dissociation),
- c. *Histrionic* – depending heavily on being centre of attention (dramatic, overemotional, dressing provocatively & easily influenced by others),
- d. *Narcissistic* – believing in having special reasons for being better or more deserving (fragile self-esteem, rely on constant approbation, resent others' success, selfish).

3. **Anxious** personality disorders:
  - a. *Avoidant* – avoid things, places or people which cause anxiety (sensitive to criticism, lonely, worry about being found out and rejected),
  - b. *Dependent* – over-dependence on others (feeling needy, weak and unable to make decisions, low self-esteem),
  - c. *Obsessive-Compulsive* – obsessive-compulsive personality disorder is separate from obsessive-compulsive disorder (behaviours not personality) and reflects problems with perfectionism, need for control, and inability to be flexible in thinking.
4. **Personality Disorder - Not Otherwise Specified (PD-NOS) Personality Disorders:**

Is as it sounds (not experiencing enough personality disorder traits that fully meet the criteria of a specific type – aka personality disorder trait specified or PD-TS).

As a side note, the hospitality industry has a reputation, for having more than its fair share of people struggling with addiction. There are many reasons for this beyond the generally antisocial hours and constant pressures of a commercial hospitality operation. Look out for the signs in yourself and others, and seek support if needed:

  - Agitation
  - Being Secretive or Dishonest
  - Defensiveness
  - Deteriorating Performance/Attendance at Work

- Isolation
- Lack of Concentrate
- Lack of Interest in Previously Important Activities
- Low Self-Esteem/Hopelessness
- Mood swings
- Paranoia
- Poor Judgement
- Poor Memory
- Poor Physical Appearance/Personal Hygiene
- Prone to Illnesses/Frequent Sick Leave
- Risk Taking, whether Financial, Legal or Social
- Temper
- Tiredness
- Withdrawal from Responsibilities and Socialising

### *Intercultural Communications*

I will add just one more note to my diatribe on communication, and that is on intercultural interactions. Sometimes, and I have found this a lot, you learn more about yourself by looking at yourself as others do, than you do from merely looking in the mirror. For this purpose, I introduce you to Geert Hofstede's 6-D Model of National Culture. If you are not already aware, Geert Hofstede, who died aged 91 in 2020, was a celebrated researcher, who developed a methodology for understanding and comparing cultures. In his model, Hofstede considered six key dimensions:

1. **Power Distance:** measures how different societies accept and expect power to be distributed, i.e. how separated people feel from power. A higher score suggests more structural distance between those who hold power and the majority of the population, while a low PDI score indicates a greater sense of equality.
2. **Individualism vs Collectivism:** identifies the difference between cultures that value the needs of the individual compared to those of the group, implying a greater sense of belonging (collectivism).
3. **Masculinity vs Femininity:** which measures the degree of achievement and assertiveness (masculinity) versus nurturing and empathy (femininity) in a culture. To be clear this is about cultural values not gender roles.

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4. **Uncertainty Avoidance:** refers to societal tolerance for risk or ambiguity. A high score means a society avoids risk, while a low score means a society is more comfortable with risk and change.
5. **Long-Term Orientation:** as the title suggests, LTO considers cultural attitudes towards planning vs more instant gratification.
6. **Indulgence vs Restraint:** is concerned with how a society weighs the desires of the population. High indulgence scores suggest a society is inclined to be more permissive, while a low score suggests greater cultural discipline.

Please understand that the model is a simplification and as such cannot, and doesn't try to, reflect every nuance of any single culture. However, it does provide a valuable framework for understanding cultural differences and promoting better cross-cultural interactions. The GH 6-D system is a useful tool for building understanding if you are working with clients or staff from overseas. It can also be educative about one's own culture and one's own behavioural tendencies. Out of context, it may be hard to understand the system or see its value, so I will give you the following comparison example between Italy, Turkey, and the UK:

I find the explanation of the British contradiction of modesty vs ambition (*what is said is not necessarily what is meant*) and the general dislike of rules but strict adherence to *queueing*, to be highly entertaining and enlightening! If you have the chance, spend some time exploring your culture in comparison to that of your friends or workmates – it helped me realise that the English sense of fair play, and what I took to be openness, was my misreading of the culture, and that actually, UK society is not open, but highly Byzantine with its nuanced class system and associated beartraps.

### Basic Negotiation and Interview Psychology

When I first started conducting market and financial feasibility studies by myself, I repeated what I had seen my seniors doing during my training. This started with booking appointments with the general managers of competitor businesses in the target location. I would then turn up, ask them some general *how's the weather*-type questions, as I edged closer to asking for what I really wanted – their performance data. This was important because without knowing what annual occupancy and what average room rate they were achieving, it was next to impossible to quantify the market with any degree of accuracy. And how are you going to project how the new hotel you've been sent to investigate is going to trade once it's built, if you don't know what is going on in the market today? The difficulty was that the GMs and I both thought we had information that the other wanted. I wanted performance data, they wanted to know why I was really there (and ideally where the site of the hotel was going to be). Then there were all the issues with confidentiality and what can legally be revealed and what can't. The question then

| Index Measure         | Italy Index Score | Turkey Index Score | UK Index Score | Interpretation of the UK Scores   |
|-----------------------|-------------------|--------------------|----------------|---|
| Power Distance        | 50                | 66                 | 35<br>low      | <p>Believes inequalities amongst people should be minimized. PDI is lower amongst the higher class than the working classes. The PDI exposes one of the inherent tensions in UK culture - the importance of birth rank vs a deep seated belief that where you are born should not limit how far you can travel in life. A sense of fair play and belief that people should be treated as equals.</p> <p>Turkey by contrast is dependent and hierarchical with the ideal boss seen as a 'father' figure. Staff expect to be told what to do. Communication is indirect and information sharing is selective.</p>   |
| Individualism         | 53                | 46                 | 76<br>high     | <p>Whether self-image is defined as 'I' or 'We'. Individualist societies people are supposed to look after themselves and their direct family only. In Collectivist societies people belong to 'in groups' that take care of them in exchange for loyalty. The UK is highly individualist and private. Children are taught to think for themselves and to seek their unique purpose and how they can contribute to society. Happiness is through fulfilment.</p> <p>While Turkish society is collectivist, with people often belonging to in-groups. Group harmony is paramount and open conflict is avoided. Relationships have priority over task fulfilment. Time must be invested to build trust and feedback is indirect.</p>  |
| Masculinity           | 70                | 45                 | 66<br>high     | <p>The UK is decisive - driven by competition, achievement and success, as opposed to caring/ quality of life. Standout from the crowd/be the best (decisive) vs being liked for what you do (Consensus). Confusion for non-UK nationals is the contradiction of modesty/understatement vs success motive. Key is to understand 'read between the lines', what is said is not always what is meant. E.g. comparison to Scandinavian countries (consensus) - people in the UK live in order to work.</p> <p>Turkey however is more consensus orientated, with more egalitarian and sympathetic attitudes. Conflict is avoided in all contexts and consensus is important.</p>  |
| Uncertainty Avoidance | 75                | 85                 | 35<br>Low      | <p>The UK has a low UAI = quite happy to wake up not knowing what the day brings and change plans as new information comes. The British are comfortable in ambiguous situations or 'muddling through'. There are generally not too many rules, but those that exist are adhered to rigidly - see <i>queueing</i> (which is related to values of fair play). In work = non-detail planning, focus on end goal. Highly curious, creative with a need for innovation. Exhibited in humour, need for new products and the creative industries. Turkish society conversely requires strong laws and rules to minimise anxiety. Possible appearance of being very religious (frequent references to Allah), but this may be as much a result of traditional social rituals.</p> |
| Long Term Orientation | 39                | 35                 | 60<br>High     | <p>How a society maintains links with its own past while dealing with the present and future. The UK is high scoring, meaning it is pragmatic - people believe that truth depends on situation, context, and time. Able to adapt to change, strong thrift (save and invest) and persevere / achieve. Low scoring = maintain traditions and view change with suspicion. In contrast, in Turkey, there is a strong need to establish the absolute truth, with great respect for traditions. There is little propensity to save for the future, with emphasis on quick results.</p>  |
| Indulgence            | 30                | 49                 | 69<br>High     | <p>The degree of indulgence, with a high willingness to realise impulses and desires, and enjoy life. Generally positive and optimistic. High importance of leisure time and spending money as desired. Indulgence is defined as the extent to which people try to control their desires and impulses, based on the way they were raised - weak control is called Indulgence and strong control is called "Restraint". Turkey has a midranking score at 49, so for contrast we consider Italy at 30. Italians in comparison to Brits, tend to be more pessimistic and cynical. They place less emphasis on the importance of leisure time and feel that indulging themselves is somewhat wrong.</p>   |

**Figure 4.6** Comparative Scores on the Hofstede Index, between Italy, Turkey and the UK.

becomes who's going to give what up first. Unfortunately, approached in this way, it quickly becomes a zero-sum game – if one reveals too much of what the other wants to know too soon, the other no longer has to reveal anything. It's a negotiation. As hostage negotiator Chris Voss highlights in his book 'Never Split the Difference': *when negotiating as if your life depended on it, you would never split the difference – I'll keep five hostages and you keep five!* Instead, you need to get to a point where everyone is as happy with the outcome as possible – *nobody dies and I get all the hostages, while you get a commuted sentence and/or perks during your jail time.* Harvard professors Roger Fisher and William Ury termed this *getting to yes*. To do this you have to get away from the zero-sum game mentality, and ascertain what the other side wants (caution: this may not be what their explicit demands are). How do you elicit the information you need to understand from someone who might have every reason to be suspicious of you? You start a conversation, build rapport, use empathy to open them up, and seek the magic nugget that reveals their true agenda or deeper motivations that you can hook on to.

We've already discovered that as humans we are very good at making generalisations, very fast and very efficiently. The difficulty with this when it comes to interacting with other humans is twofold: i) these judgements are all too often related to our more primitive desires, and ii) we are prone to missing a lot, there may be more to a set of circumstances than can be brought to the surface in a split-second analysis. Daniel Kahneman refers to this a WYSIATI (*what you see is all there is*), which means just that. Once our System 1 has delivered its assessment of the situation, it considers its job done, and with its assignment complete it doesn't do any further analysis. Neurolinguistic programming experts like Tom Hoobyar capture the System 1 analysis in the acronym GGNEE (Gender, Generation, Nationality, Education & Emotion). When we first meet someone, in a fraction of a second, we assess their:

- i) **Gender** – the same as us or not?
- ii) **Generation** – are they a child or elderly, possibly needing our care, or are they of reproductive age?
- iii) **Nationality** – (euphemistically) includes race or ethnicity, does this trigger likeness warmth or difference suspicion?
- iv) **Education** – are they smarter than us? What is their partnership potential?
- v) **Emotion** – what emotional state are they in right now? Are we on the defence?

Once we've run this process, we stop, we're not listening unless there was something in our assessment that caught our attention, and that might benefit or threaten us. As discussed previously, stereotyping is closed-mindedness, and does not move us forward in terms of accurate understanding. We need to go

further in our exploration and information gathering. It is a natural urge to be liked, but we can't necessarily tell if we're liked right away. Yes, slightly open mouth, smiles and so on might give an indication that we're on the right track, but our subconscious looks for other cues. One of our brain's favourite shortcuts is, *is this person like me?* heuristic – if they're like me, they must like me. Both hostage negotiators and NLP experts agree you can start to give the impression of liking by holding someone's gaze for a fraction longer, offering a warm smile and then mirroring their actions. The FBI will reportedly insert an apology for some minor or irrelevant indiscretion (as it makes you seem more trustworthy), then repeat the last three words the other person has just said, and then leave a void of silence that they will instinctively want to fill, usually with less guarded chat. Don't forget, this is not a conflict, this is a mission of discovery, so move your own thoughts away from the first person perspective (the one with all the '*I*' wants), to the second person perspective (the empathetic understanding) and then to the third party observer (you can use Kipling's *Six Good Men* – like a journalist asking questions and taking notes to get to the bottom of a news event). In mirroring, it's not advisable to physically copy others move-for-move like a comic mime artist – that's just creepy, annoying and will create a tension rather than building trust. As a side note, and in a scientific test, waiters who repeated customers' orders back to them were tipped on average 70% more than those who did not. You can also match their behaviours, or non-verbal cues as they are sometimes referred to. If they've folded their arms, we can fold ours. If they're casual and confident, we should be the same. In addition, there are thought to be three ways in which we all process information that inform how we can mirror people we wish to connect with:

- 1 Visually (through pictures),
- 2 Auditorily (through words and sounds), and
- 3 Kinaesthetically (through feeling).

Visual thinkers conjure an image of what they're processing and therefore see it all at once, meaning they will speak more quickly than others. To match their approach, we can speed up our speech, gesticulate with our arms and use phrasing that fits (*I see what you're getting at, looks good to me, etc.*). Auditory people tend to speak at normal conversation speed (the speed of a news reader or audiobook), and will feel comfortable with a deep, mellow, slow voice with easy speech patterns (in fact this can be a good style to adopt universally, just as long as it is positive). They will respond to sentences such as *I hear what you're saying, I'm listening, sounds good to me, etc.* Meanwhile, because kinaesthetic characters are more tactile, but may not be able to physically touch what they are assessing, they will try out ideas in their heads, approaching them from all directions, with the result that they will tend to speak more slowly (there is more processing going on, which takes time). They will feel comfortable with sentences that emphasise

touch sensations or movement, such as *I feel we should wrap our minds around this, let's grasp the nettle, we need to get a handle on this*, etc. Further, we should always remain curious and interested in the person we are speaking to (after all we're trying to gather information that might be of relevance to our objective).

To help develop empathy, it can be helpful to label any pain that the other person is feeling. When I visited general managers in what were traditionally considered hardship locations, I learned to say early on things like *'it seems like this is a high-pressure territory'*, *'I bet it's hard work getting things done here'*, or asking a question that did the same job *'is it tough finding the right sort of people to work here?'* You can take things a step further with questions that aim directly at the threats that unsettle someone by asking what change would make the fear go away? *Will the arrival of your new chef solve the food service issues, would a change in the government administration change things for the better?* Another technique is to just come straight out with all the negatives about yourself, your role or why you're there, which takes the wind out of the arguments before they're made – *you must get fed up with annoying consultants like me showing up, and taking all your time when you've got 1,001 better things you could be getting on with*. You can make a list of all the things that count against you and use them in this way (I also use this technique when pitching for work – *I'm sure you're thinking 'why choose this guy? He's only a single operator'* – your prospective client will likely start backing you and giving you the answer to the question you just posed). At the end of the day, you are looking to soothe the amygdala (the part of the brain that registers threats and fear) by creating a safe space for the person you're talking to. You can tell what state of anxiety a person is in from their words, tone and body language. Demonstrating that you're like them, are listening to them (showing genuine interest), understand them/their circumstances (being empathetic), and along with others, appreciate them and their efforts. You can also throw in not invading their space and where appropriate physically connecting with them.

Finally, in a negotiation you need to elicit and lance the 'no'. If you have an ask in your negotiation, you want to get the *no* out of the way as early on as possible so that the *no* is not used on your ask. What I mean is, you want to pre-emptively get your opponent to say no to something else first. It empowers them, makes them feel in control, as well as possibly removing any sense of reactance and maybe even triggering a positive reciprocation response. Once someone has said no, they find it much easier to say yes to whatever comes next. Remember, no may not be outright, instead it may just be a passive request for more information or hold another meaning that is hidden behind the no, and yes is not necessarily yes either, it can mean no. That yes that holds no intention of doing what was suggested, but is used just to get off the hook – the *will you look me up when you next visit? Yeah sure, I'll do that* type of yes or the more oblique *you must come to our BBQ this weekend* (btw Brits will believe you have invited them if you say this, so be prepared for them to show up or at least ask for directions and the time of the party). Be sure you get a real yes, ideally with a specific commitment and a timeline. You can also

use some of the techniques we discussed previously to set the price you want to achieve, or to create urgency and so on, but if you really want to master negotiation, I suggest you read 'Never Split the Difference', Chris Voss is a true expert on the subject and can do it far greater justice than I can here.

### ***Complaint Handling***

Very briefly, before we look at how you can tell if the person you've been talking to has been not been entirely candid, we will do a dance through customer complaint handling. Before we start, however, I would like to emphasise how important it is to get this right. There will always be guests who are frustrated by something or other, this may or may not be reasonable or for that matter, within your control (remember *fundamental attribution* – it is what is going on in the moment that has the greatest impact on people's behaviour). However, you have an opportunity when faced with a guest complaint. You *can* do that thing that some chefs do, and blame the guest for not respecting the process, or you can win the guest's loyalty, *forever*. That's a big claim, I know. Science has demonstrated that guests who are disappointed with something during their stay and have it efficiently resolved, will show increased loyalty to the brand. If something is not up to scratch, resulting in guest dissatisfaction and the manager takes action to put it right, ideally unpromised and actioned behind the scenes, the guest can be wowed into undying devotion by this personalisation of service. *The customer is always right*, is therefore a non sequitur, sometimes they're right, sometimes they're wrong, who cares? – thrill them and they'll become your greatest advocate.

When someone comes to the front desk with a frown and slams their fist on the counter, you don't need to ask them if they're upset, that much is obvious. But you should consider what is upsetting them and what the nature of their upset is. Best thing to do is, politely ask them and brace while their fury is unleashed (that means adopting the confident adult stance – feet shoulder width apart, knees very slightly bent, and listening until they've finished their rant). If you interrupt them mid flow, they will start back at the beginning. Think of a dedicated climber trying to summit the mountain of complaint. Each time you interrupt, you knock them back down to the bottom, where they will start over until they finally get to the top. The more you interrupt the more they will go again. If you wait until they have truly finished getting it out of their system, you will hear an actual sigh, this marks the completion of their climb, they're made the top and stuck a flag in it. Now and only now can you help resolve whatever it is that has upset them. Don't be afraid of asking for more information on specifics of what has gone wrong, malfunctioned, or disappointed them – be interested, write down details if it helps make sure you address all the elements of the matter. If it is an easy fix, fix it and then follow up afterwards to make sure it has been resolved to their satisfaction. If it is going to take longer, tell them that, offer them a seat and a beverage/other and give them an accurate timeframe for how long you think it will take to resolve (don't underestimate this or you risk creating further annoyance). If you think it can't be resolved, come up with alternatives

that solve the problem behind the problem (*my key snapped off in my door and I can't get into my room* – might be more specifically, *I've been skiing all day and I'm desperate to get out of my stinky gear and go and do some apré*). You can use all of the mirroring and empathy skills we just discussed, too. Failing all of that, admit that you don't think you can provide an answer or solution and ask them whether they think there is something else you haven't thought of (do this early on if you think it might be a scam, it's a great way to smoke out whether they're after compensation of some sort).

As a tip to avoid provoking frustration at the outset of a guest stay – when you they approach you, but you are already dealing with another customer, for your own sake don't ignore them. Acknowledge them and tell them you'll be with them in a moment (they can see you're busy and so they'll understand). If you ignore them you'll very quickly get huffing and puffing at the very least. The same principle applies, if the phone rings off the hook while you're helping a guest – they can hear it too and are probably getting just as irritated as you are. Apologise to the guest in front of you, tell them that you're going to answer the phone, to get the caller's details to call them back later.

### ***Assessing if They're Telling the Truth***

Lastly in this chapter, we're going to look at some simple clues to help you determine if people are being truthful with you (whether that's your team, contractors, suppliers or customers). Before we spend a lot of time thinking about asking questions, now we move to questioning answers.

I know, you're saying *why are we looking at this? people are fundamentally honest and tell the truth*. Studies have shown that on average we all lie around ten times a day (mostly small insignificant lies of little or no importance, but still lies). What's more, we know that we lie to ourselves (with our System 1 biases particularly) and we should realise that truth and logic are not always the same thing, and that people can be incongruent – they can exhibit both truthful and deceitful behaviours.

Right, now let's think like a detective. As we know, our unconscious brain operates fast and automatically, faster than our pondering, conscious brain. The key to telling if someone is being truthful is to seek the flags that get waved in between the two parts of the brain. To illustrate, we normally speak at 125–150 words per minute, yet our System 1 operates at around ten times this speed. Typically, if we are asked a question that relates to something we don't like or don't want to admit to, it triggers an instant involuntary response, and the more responses in the first five seconds after being asked the question, the more it demonstrates our discomfort with what we've been asked. This in turn indicates that either we're lying or that the issue is so disquieting that we can't bring ourselves to even think about it. You can probably ignore single indicators of deceptive behaviours, but when you get a cluster of them in the golden five seconds, pay attention and

go carefully with your questioning. The types of responses are both verbal and non-verbal, so it is important to learn to both listen closely to what is being said and to watch for tells, a bit like a poker player.

Ideally we would do this in a dedicated space at a dedicated time – it makes life much more difficult trying to spot tells in a busy workplace, so find a quiet place, away from distractions if you can. Once you've got the environment right, think carefully about your questions. You want to extend the conversation for as long as you can to give time to elicit the involuntary responses you're watching for. You want to pursue lines of questioning that seem to elicit more responses than those that don't. Ideally, you want to get the person to make a confession rather than getting them say *yes* to an accusation. Avoid direct questions that might afford your suspect the opportunity to make a denial. Once someone has denied the deceit or crime they will find it easier to keep doing so – you want to get an admission without asking for it. Listen carefully for...the truth, the whole truth & nothing but the truth...the words of many a courtroom drama that we're all familiar with. What it alludes to is that there are three sorts of lie:

- i) Commission – bare-faced lies,
- ii) Omission – what isn't said that should be,
- iii) Influence – attempts to influence perception by providing more information than is necessary and hide the untruth in the noise.

Remember, when people aim to deceive, they tend to say too much or too little and that nonverbal actions approximate from anywhere from 66% to 90% of communication. Now for the tells to watch out for, which (when exhibited in clusters, within the five second window after asking) will give your suspect away:

- i) **Anchor Point Movement** – parts of body that anchor a spot or position: if standing, it's the feet, if sitting it could be buttocks and feet, or hands in lap/on table or elbow on chair. Even movement of their chair/etc.
- ii) **Convincing Statements** – particularly if you get two or more of these,
- iii) **Denial Problems** – when you ask the direct question there is an absence of explicit denial,
- iv) **Failure or Reluctance to Answer** the question - deflection or distraction or answering a different or unrelated question,
- v) **Failure to Understand** simple questions,
- vi) **Grooming Gestures** – preening oneself or tidying the surrounding area (straightening tie, cuffs, glasses, skirt, putting hair behind ears, wiping sweat,
- vii) **Hand to Face Activity** - biting lips, pulling ears/lips,

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- viii) **Hiding Mouth/Eyes** – including closing eyes,
- ix) **Inappropriate Behaviour** - smiling or laughing (or even self-harming),
- x) **Inappropriate concern**,
- xi) **Inappropriate politeness**,
- xii) **Inconsistent statements**,
- xiii) **Invoking Religion** (or demonstrating devotion) – *oh for God's sake* etc.,
- xiv) **Non-Answer Statements** – *I knew you'd ask me that*,
- xv) **Overly Specific Answers** – too much detail,
- xvi) **Process or Procedural Complaints**,
- xvii) **Referral Statements** – offering up other candidates,
- xviii) **Repeating the Question** – buying time to fabricate a deceit,
- xix) **Selective Memory**,
- xx) **Throat Clearing**/swallowing before answering the question (not afterwards),
- xxi) **Using Qualifiers** – of exclusion (basically, probably), or perception (frankly, honestly),
- xxii) **Verbal/Nonverbal Incongruence** – what is said doesn't match behaviour with narrative answers.

Look for Unintended Messaging – literalness is key. A liar doesn't have the facts to help them, so they will look for those that do. Innocent people will usually be able to answer questions without having to process. A guilty person will likely have rehearsed certain questions – think of those they might not have practiced. Keep questions: short, simple, singular in meaning, straightforward. You can use presumptive questions like '*what happened that night...?*' or bait questions that might trigger an involuntary response, such as, '*is there any reason your colleague would say you...?*'. Open-ended questions can be useful to explore opinions, particularly in context, on what sort of punishment should be administered to a guilty person – inappropriate leniency is a possible tell. Another open-ended catch-all question might reveal more than you were expecting, '*so, what haven't we discussed that might be important...?*'. Otherwise, closed-ended questions on specifics, with clarifications, using evaluation questions like '*why would you say that?*', exploration questions '*I don't understand, tell me more*' or straight clarification questions, '*is it possible that...?*'. You can also use the *possible* question - '*I know it's a long-time ago, but is it possible that...?*'. Finally, practice watching politicians on the news, it's a great way to spot deceptive behaviours!

# Chapter 5

## P3: PROFIT (Think Like an Investor)

### The Difference Between a Hobby and a Business

#### Introduction

Before we can talk about profit, it is important to know how money thinks and how money works. We need to start wide and then zoom in to specifics.

To do this, I would like you to imagine a new reality TV game show, called *Live Island*, where five contestants are sent to a desert island for a year. The island is split into five equally-sized plots around its edge, with one given to each player, plus a central plot that is owned by *God* (the producers fulfil this role as they tend to in these types of show). On the island, there is fresh spring water on God's plot that is available to all for free. Each plot contains a mango tree that produces 50 mangoes per year, and mangoes are the only food source (imagine the players are happy with mangoes for now, even though it's going to do a number on their bellies – bear with me on this). The producers give each contestant 100 shells (the local currency) in case they want to buy additional mangoes from each other on the days they feel hungrier. So the game begins and over the year, the island's collection of mango trees produce a total of  $50 \times 5 = 250$  mangoes. Each contestant has 100 shells so the total amount of currency in circulation on the island is  $5 \times 100$  shells = 500 shells. At this point, the total economy of *Live Island* can be

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represented as 250 mangoes = 500 shells, which would allow a casual observer to deduce that the average price of a mango at any one point would be  $500 \div 250 = 2$  shells each. Good so far? Great, let's imagine that the players get sick of just watching and waiting for their mangoes to grow (not to mention what this simple diet is doing to their insides) and start to do other things:

- A decides to catch fish (240 per year),
- B is good at making shelters so makes buildings for people (10 per year),
- C makes crockery, cutlery and tools (100 per year),
- D makes clothes (100 garments per year), and
- E grows vegetables (300 per year).

At this point in the year the collective output of *Live Island* is 250 mangoes (they keep growing regardless), 240 fish, 10 buildings, 100 knives and forks, 100 sweat shirts and loin cloths, and 300 assorted vegetables (that's going to work well with the mangoes, phew!) per year. A grand total of:

250

240

10

100

100

300

1,000 units of production.

Now, the number of shells hasn't increased at this point, so the average price of a unit of production is  $500 \div 1,000 = 0.5$  shells per unit. Then one night God creates a storm that washes up another 1,000 shells on A's shoreline. Whether A decides to share her new bounty or not, the addition of these new shells into the system means that there are now 1,500 shells in circulation  $\div 1,000$  units of production = an average price per unit of 1.5 shells per unit. It's a whole 1 shell increase in the average price of everything (from 0.5 shells to 1.5 shells is a 200% increase – that's quite some inflation!).

Now to complete the picture, let's suppose God decrees there will be a market ten times a year on his plot, when everyone shall bring any surplus produce they

don't need to trade with the other contestants. At each market, people spend an average of 10 shells each (so 10 shells x 5 contestants x 10 markets per year = 500 shells changing hands per year). Consider they only trade once per market and that they use the shells they've saved up as well as the shells they receive in the trades at the market. Shells are now circulating in the *Live Island* economy at 500 shells per year, effectively increasing the number of shells by that amount each year to 2,000 shells (an increase of one third or  $500 \div 1,500 = 0.33333$ ).

So, if the number of shells in circulation is now 2,000 and the output of *Live Island* remains constant at 1,000 units, the average price per unit will increase to  $2,000 \div 1,000 = 2$  shells each. If you put it into an equation, it would look something like:

$$1,500 \text{ shells } \times 1.3333 = 2 \text{ shells } \times 1,000 \text{ units of production}$$

And might otherwise be represented as follows:

$$MV = PY$$

Or

$$\text{Money } \times \text{Velocity} = \text{Price } \times \text{Output } (Y)$$

Where **Money** = all the money in supply

**Velocity** = the speed at which money circulates

**Price** = the price of all goods and services

**Y (output)** = the total output of the economy

In economics, this is called the equation of exchange, and the notion that the total output of the economy equals the total money in supply, was first postulated by Nicolaus Copernicus, in Poland in the 15<sup>th</sup> century. Today this model forms the basis of monetary policy, and although they may disagree on the specific mechanics, most educated economists agree this is broadly how things work regardless of their school, unless of course their politics blind their economic understanding first (as with modern monetary policy, which isn't really monetary policy at all, more a re-engineering of  $MV=PY$  to suit social conscience).  $MV = PY$  is sometimes also known as the model of quantity theory (and models are simplifications of the real world to predict what is likely to happen when we pull a particular lever, just as maps cannot be the same size or show the same detail as the real thing without being the real thing, which would clearly defeat their purpose).

Where Keynesians and monetarists will disagree is over what remains constant and what changes and how quickly. In the model (I'm presenting the monetarist view here), velocity and output are considered to remain constant over the short to medium term, with increases or decreases in output usually only occurring gradually (except in instances like the global pandemic, when it fell off a cliff), as it is assumed the economy is already running at near full capacity and to tool up takes time and investment. Velocity or the number of times money changes hands, only typically changes with the advent of new technology, like the ATM or electronic banking (except during COVID when it fell dramatically as we couldn't get out and spend for a while (except on guitars). Therefore, price is determined for the most part by the money supply, and the greatest influence on the money supply tends to be government and the banking system.

Increases or decreases in M can have such a dramatic effect on prices that in most Western economies, its direct control has been handed over to the central banks. If you think this sounds like an exaggeration, take the time of Pizarro's defeat of the Inca Empire around 500 years ago, when monetary policy was unheard of and the conquistadors started hauling vast amounts of gold and silver back home to Spain. Seeing the *Treasure Fleet* returning laden with riches, the people thought things were on the up. What they didn't count on was the 600% inflation it gave them that meant that even staples became unaffordable for ordinary folk.

The interesting thing about inflation that is largely overlooked by the popular press, is that it is not usually evenly distributed across the economy. This is partly because consumer price index inflation (CPI or equivalent) as a measure is very limited in what it shows (statisticians gather price data across what is called a *basket of goods*, simply a selection of ordinary items, to see if average prices are increasing). Instead, inflation often occurs, or at least starts, in smaller pockets and that is down to where the increase in the money supply comes from and who has access to the new money in the system.

During the 1990s into the early 2000s, central banks had been concerned about a possible economic slump and so increased the money supply to *stimulate growth* (we'll ignore the political actions here). Nothing happened, no inflation, not a peep. So the then governor of the Bank of England, in a turn of hubris, declared it the NICE period (No Inflation Constant Expansion). Except it wasn't really true; inflation was there, it just hadn't manifested itself immediately because of who got their spanners on the cash. The money was injected into the banking system, so that only investment banks and high rollers were able to access it. And where did these banks and individuals put the money? All sorts of things, in truth, but a lot went straight into loans to the real estate sector – they couldn't give loans away fast enough. That ended in the global financial crisis (GFC) that almost destroyed the world's entire banking system and many national economies along with it.

Skip forward to the pandemic of the early 2020s, and governments did bail-outs big time – companies of all sizes and us, the public, were given cash like it was going out of style. We just got delayed in spending it (apart from on those guitars or anything else Amazon could squeeze through the letterbox). Once we were *unlocked*, spending went nuts, except this time it wasn't those high-faluting folks creating sub-prime mortgages and synthetic investments, it was the hoi polloi spending on everyday things, like holidays, campervans, tech toys, eating out, even the supermarket shop. When supply couldn't match demand, prices jumped by 10%+ per year, remember it? Now, some of this was down to geopolitics and supply chain issues, but the main trigger was an increase in the money supply of around 25%, which fed through in equivalent inflation over two and a half years.

With all that out on the table and as a very quick summary of the two main schools of economic thought:

The Keynesians (John Keynes, modern monetary theorists and the like) consider that *animal spirits* are at work in man and the economy, creating busts and booms willy-nilly. It is therefore the job of government to intervene, and smooth things out between the peaks and the troughs – stimulating growth when the economy slows and putting the brakes on it when it runs away with itself. This is largely conducted through fiscal policy: essentially taxation and government spending (usually borrowed money spent on national infrastructure projects, where the money goes into raw materials, professional services and labour, to get it into the wider system) and can sound perfectly reasonable...in fact, as I write, it almost sounds sensible to me...until you remind me the Keynesians are still in love with the archaic IS-LM model, pah! The IS-LM model (Investment-Savings, Liquidity preference-Money Supply model, 1936) or Hicks-Hansen model, is a teaching tool that aims to illustrate a notional short-term equilibrium point of both interest rates and output when prices do not appreciably change. Despite the fact that it did not reflect the real world, it was used to justify government intervention in the economy (particularly through fiscal stimulus), at the time of the Great Depression (although, I suspect that Keynes hoped it would stimulate a new stock market bubble to revive the fortunes of the people whose money he had invested and lost). IS-LM was superseded by the AD-AS or aggregate demand-aggregate supply model in the 1950s, and while both may still be used as simplifications to introduce students to theory, they have been replaced by the DSGE (dynamic stochastic general equilibrium) models now used by central banks.

The monetarists (Milton Friedman, et al) consider the money supply to be the main influencing factor affecting the economy and it should be controlled using interest rates primarily. Booms and busts, according to monetarists are created by bad policy (whether it's excessive, borrowed government spending, or misaligned taxes and legislation that create unintended incentives

and consequences). Lose control of the money supply or tax the wrong thing and you'll either get broad-spectrum inflation or a bubble in a single asset class, with the following bust. They think government should therefore only spend what it has taken from taxes and earnings, and not spend (borrowed) money to stimulate the economy. Sadly, this all sounds quite boring, stingy and less appealing – it certainly doesn't have a feel-good factor, plus it's much harder to explain (as I've just demonstrated).

You might think this is all rather unimportant, but I beg of you, when a politician asks for your vote, whether right-wing populist or left-wing socialist, look very closely at their spending pledges. If they offer largesse and dreams of a bright future, check their promises are fully costed (with a contingency), otherwise pesky inflation will rear its ugly head and make you a lot poorer sometime in the future. Also keep an eye on the political stance of the chair and policy committee of the central bank – they're paid to keep the economy safe, not redress historic societal imbalances or social wrongs.

So, central banks mostly control the money supply to control inflation through interest rates or quantitative easing (QE). The two processes are quite different and before we look at them, I have to explain one other significant element in the life of money: the multiplier. The multiplier effectively amplifies or magnifies monetary policy and to some extent, helps explain the monetarist's fixation with the money supply.

Most people think that when they put their cash in the bank for safe keeping, the bank takes that money and lends say £0.95 or every £1 deposited, to people who want mortgages, and they keep £0.05 back (or 5% of all the pounds entrusted to them), in case you or I want to draw out £50 tomorrow. This is only part of the picture. The reality is quite topsy-turvy. Yes, the bank does lend your money (and yes, you are a creditor to the bank in that sense – I don't suggest you waste your breath reminding them of that anytime soon, though), but because globally we operate a *fractional reserve* banking system, for every £, \$, € or ¥ we deposit, the bank can actually lend around twenty £s, \$s, €s or ¥s. This is because under agreements such as Basel III (the international banking regulations created by the Basel Committee in Switzerland), banks are only required to maintain a *capital ratio* of approx. 5%, i.e. of all the money they lend (not of what is deposited) they have to keep 5% in cash of liquid assets. In other words, if you deposit €1 and this equals only 5% of the money they're required to keep, 100% would be  $100 \div 5$  or 20 times that amount. They can effectively create money that didn't exist before. This and the deregulation of the Clinton era in the 1990s, lay behind much of the GFC.

Incidentally, banks are in the business of asset transformation (they take short-term deposits and turn them into long-term investments, like mortgages), and a *bank run* is when people lose confidence in the bank and start a race to withdraw their money from the cash reserve before it runs out (and the bank can't liquidate its long-term investments quickly enough).

Ok, as simply as I can: Quantitative Easing (QE), is an ill-advised monetary policy to help stimulate the economy (ill-advised because it always results in inflation somewhere, at some time, unless output can catch up with increases in the money supply, which it rarely, if ever, can). Essentially, the central bank creates new money, by buying assets like bonds from financial institutions with money it doesn't actually have on deposit (effectively lowering its own capital ratio and allowing itself to borrow more money).

Interest rates are set by the monetary policy committee at most central banks. The MPC or equivalent, sits down and having had their boffins analyse the economy, decides whether to increase, hold or reduce interest rates in order to maintain inflation at or just below target levels. While the central bank is the Lender of Last Resort that provides financial support to individual banks in times of crisis, during normal times, it is a significant player as regulator and lender to the wider sector. The central bank's interest rate sets the interbank lending rate, i.e. the interest rate just for banks. If the central bank increases the interest on money it lends to banks who have deposits with it, they in turn will increase their interest rates accordingly. Why? Because the central bank is essentially the national bank, and is operated to never fail and to never renege on any of its financial obligations (i.e. it will always pay back any money lent to it). If needs be, it can always print the money (figuratively) to pay back loans (there are of course problems with this, but they can do it in theory).

## **The Time Value of Money & Risk and Return**

The time value of money reflects the idea that money is worth more now than in the future. Why? Partly because of inflation (we've all seen how inflation makes the money you had in the bank worth less a year later), but the main reason it is worth less in the future is because of risk and opportunity cost. This is down to the fact that money that can be invested today can earn a return tomorrow that is not guaranteed. Plus, if money is not invested today, it has lost the ability to earn a return today and therefore value has been missed or lost. This can possibly be illustrated when we consider Warren Buffet's (and Charlie Munger's) investment ethos at Berkshire Hathaway, of using the practice of compounding – if you invest \$1,000 in a bank account at 5% interest rate, you will earn \$50 in the year. Then if you reinvest that simple interest earned in the same bank account (allowing it to compound), it will earn you \$52.50 in the second year, and \$55.13 in the third year and so on, in terms of compound interest. Now, if you leave that investment compounding, your original investment of \$1,000 at year 0 it will be worth \$2,653.30 by year 20 (an increase of \$1,650.30 or 165%). If you don't invest at the beginning, or if you don't reinvest your interest in one year, you are missing out on this.

As psychologists have measured, we may instinctively understand this. People when presented with a choice of say paying either £208 for an annual magazine

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subscription up front, or £4 per week for a year, they will mostly choose the weekly amount. However, they would also be likely to do this if the weekly amount was £6 per week rather than paying £208 annually (which would of course mean they ended up paying a total of £312 per year or 50% more for the privilege). Be aware of tempting offers to lure you in by disguising the total amount by using time.

The reason the rate the central bank sets is important is that it sets the price for the *risk-free* cost of money. If I am a speculator and can put my money wherever I want, I will choose where to invest on the basis of a return + the risk-free rate (why would I put money into something risky unless it is going to pay me more than the risk-free investment?). After all, there must be an incentive to take risk. This is possibly clearest with bonds.

A bond is a promise to pay back a sum of money at a predetermined time in the future (the maturity date) i.e. a loan that people can buy from a company or government. The seller (or issuer) of the bond (say the UK government) sets the interest rate (or coupon) payable on the loan at the time of issue. The buyer of the bond decides how much the interest is worth to them and how much they're prepared to pay for it (the market price of the bond on the bond market). A bond yield is the annual interest rate divided by the market price. The issuer pays interest on the bond (usually twice a year) until it matures. Bonds can be short-term issues (3 months) through to long terms (of 10+ years). At maturity, the loan principal (the total amount originally borrowed) is paid back to the buyer of the bond. Imagine the following example:

BigBucks PLC issues a bond of €100. The coupon is 4% (i.e. they will pay €4 per year in interest on the €100 loan/bond). Ms Mug comes along and says, *hmm, I need somewhere relatively safe to put some money and I think BigBucks PLC is a stable company, I'll buy one of their bonds.* Ms Mug calls her brokers and instructs them to buy 1 bond at market price. Mug's broker advises that the central bank has just increased interest rates from 3% to 5% (the base rate or federal funds rate). Bonds are consequently trading at a discount, so you can pick up a €100 BigBucks PLC bond (with a 4% coupon) for only €66.67, giving a 6% yield (the €4 interest payment divided by €66.67 market price). However stable a company, BigBucks PLC is still riskier than the central bank and so needs to offer an incentive to its lenders (bond holders/purchasers).

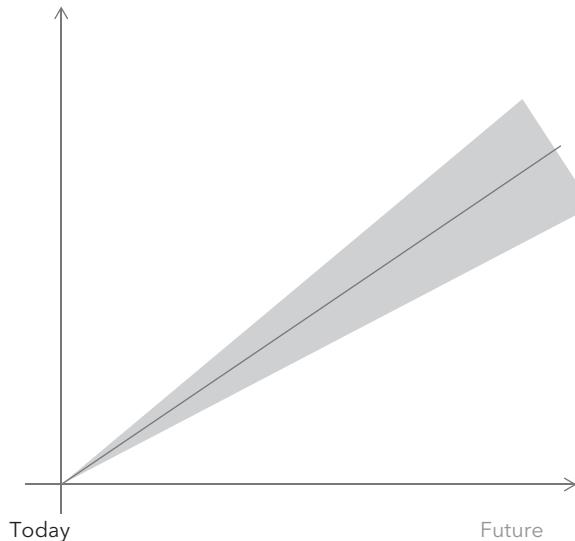
In the example, upon issue the original BigBucks PLC bond was priced at €100 with a 4% coupon, meaning it would pay €4 interest annually. At this time, the base rate was 3%, so BigBucks PLC was offering to pay 1% more interest than the central bank, as an incentive to reflect the added risk. Due to the change in the base rate from 3% to 5%, the market price of the BigBucks PLC bond had to change to ensure it still paid 1% more interest than the new base rate, i.e.  $5\% + 1\% = 6\%$ . As the bond's coupon % can't change once it's been issued (it's a fixed

rate bond), only the bond's purchase price can change to give a 6% yield. Consequently, the price had to drop to €66.67 to make the coupon payment (€4) equal 6%. So you can see that if (base) interest rates go up, bond prices go down, and if they go down bond prices go up. As we have seen, bond issuers will typically offer an incentive to attract buyers that reflects current base rate. Some investors in the bond market will want to make money on the change in price of bonds (as well as on any coupon payments made), and so will speculate as to whether base rate is going to go up or down before they buy or sell their bonds. If they think interest rates are going to go down, they can predict with reasonable certainty that bond prices will increase, and so might buy now to benefit from the increase in value when it comes (this is called *going long* or a *long position*). Conversely, if they think interest rates are going to go up, and bond prices will fall, they may well *short* the bond. *Shorting* a bond (or holding a *short position*) means, borrowing a bond at say \$10 and promising to give it back in a month at the market price, which you expect will be lower by then. You have to make a payment in return for the loan of the bond and there are all sorts of fees for doing this, so you calculate that the fall in price will be enough to cover the cost of borrowing the bond.

Example, *Barry-the-Bond* owns a BigBucks PLC bond he bought for €100. Barry loses a bet with his mate and needs to pay him €10 by tomorrow or else. He needs €10 quickly, but the maturity on his bond is not for another 6 months, and more importantly, since he bought the bond its value has fallen on the market to €90, so he would lose €10 on the nose if he sold it today. He doesn't want to crystallise that loss. Luckily, *Sharp-Steve* got a tip that interest rates are going to go up (and so bond prices are going to fall even further) and so he asks to borrow Barry's €90 bond for €10 per month, for 1 month (coincidentally enough to pay off Barry's gambling debt before tomorrow). After one month Steve will give Barry a €90 BigBucks PLC bond back. Steve immediately sells the bond Barry lent to him for €90 and pays Barry the €10 fee, so he has net cash of €80 in his bank account. Sure enough (and to Steve's great relief), interest rates go up and now a BigBucks PLC bond is trading at €50. Steve buy the bond at the new lower price and give it back to Barry at the end of the month, making a cool €30 profit on the way (€80 net cash from the sale of the bond in the first place, less the €10 fee and the €50 to buy the bond to give back to Barry).

While we're here, it's worth looking at a couple of terms that sound complex and that you will hear used quite frequently in financial circles (but that are really a lot simpler than people make out) – *inverted yield curves* and *swaps*.

Typically, in any normal period, interest rates tend to be higher for longer term loans. Why? because of the perceived risks associated with money over time. If an investor buys a long-term bond, of say 10 years, they will worry that that the annual interest they will receive from the bond will be worth less and less as it heads towards maturity. Time equals risk and that risk increases the further into



**Figure 5.1** Illustrates how future forecasts 'fan-out' as they get further away from today

the future we go, simply because we are less able to accurately predict what is going to happen (think of the fan diagrams you'll see issued by the World Bank etc. – the forecast starts off narrowly with little variance, getting wider and wider as uncertainty increases).

As a result, the issuer of the long-term bond will usually need to offer an increased incentive (higher coupon) to entice the investor to put their money in for so long. An inverted yield curve reflects a contrary logic, when short-term interest rates (coupons) are higher than long-term ones. The intuition is that the market expects short-term bond interest rates will fall, because they expect the central bank will take action to protect a weak or deteriorating economy. Inverted yield curves are often seen as a harbinger of doom because of this.

This notion ties in with the other term I said we'd look at – the swap rate or simply swaps. I could tell you that swap rates are derivative contracts between financial institutions, but to most people this means nothing, so let's break it down and start with what a swap is. A swap is simply a fixed interest rate that is *swapped* for a variable interest rate. You might take out a mortgage over 25 years, and select one that has a fixed interest rate for the first 5 years – you want to know where you're at with your budgeting and you don't want any nasty surprises. Then a while later, you see that interest rates have gone down and that you could be paying a lot less on your mortgage, except you fixed your interest rate and there are still several years left to go at the fixed rate. At this point, you wish you'd been bolder and gone for a variable rate on your mortgage that would have

gone down with the market interest rate. This is where the swap comes in – two parties swap their interest rate payments, so a borrower can change their loan from fixed to a variable rate and the lender can reduce their exposure to interest rate fluctuations. The principle can be applied to all sorts of things and companies typically will use swaps to reduce the risk of exchange rate fluctuations when they're trading internationally.

Looking at the swap through the lens of a lender, the swap rate (the price for swapping) is essentially a prediction of what the market thinks will happen to interest rates and so they can use it to set their fixed rates (high swap rates = high fixed rate and vice-versa). Key to understanding this is getting a grasp of the *notional amount* (or value) The notional amount (sometimes the notional principal amount) is the hypothetical value against which the payments are set. As we've seen when someone buys a bond, they pay a principal amount when they make the purchase, then they receive the coupon until maturity of the bond when they get the principal back. With a swap the principal doesn't change ownership, it is only the payments that change – I borrow £100 at a fixed rate of 5% per annum i.e. £5 per year, and I swap that for a variable rate at say base rate plus 1%, so maybe  $3\% + 1\% = 4\%$ , and the payments are calculated off the *notional amount* of £100, in this case that is £4 p.a., but in six months' time, the base rate may have gone up to 4.5% so the payments change to £5.50. I still owe the £100, I've just swapped how much I pay each year in interest and the risk associated with it.

If we briefly circle back to the risk-free price of money, we need to look at asset pricing and its relationship to risk. What does that mean? Well, for example the price of a stock, an equity or a share (literally the share of a company's ownership), will reflect the amount of risk associated with the company and how much it will earn (and pay as dividends to its shareholders or reinvest into its own growth). The standard method for calculating the price of the share is the capital asset pricing model (CAPM). CAPM puts risk and return on the same graph and is based on the risk-free rate and the incentive (premium) needed to reward the additional risk of investing in a company vs a risk-free government-backed asset. Another feature of CAPM is that it makes allowance for systematic risk, market risk or undiversifiable risk. This is the risk associated with the entire market, as opposed to the risk associated with a specific firm (the unsystematic risk), because if you invest widely enough, in enough firms, you can balance out their risks – some will do well, others will do less so, but in the end you balance out the risk (the diversifiable risk). Systematic risk affects the whole market (whether caused by economic, financial or geopolitical shocks) and generally cannot be easily avoided.

To explain CAPM, imagine a graph with expected returns along one axis (the Y axis/vertical axis) and expected risk (the X axis/horizontal one). In finance, expected risk is normally calculated by looking at the fluctuation of a stock's price around the average price (the mean) in terms of standard deviation (and expected return is the stock's average earnings or dividends).

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Quick recap on standard deviation:

- i) Get the average of all your data points,
- ii) Subtract the average from each data point,
- iii) Take what's left for each one and square it (times it by itself – it gets rid of any minuses),
- iv) Add all the squared differences and divide the total by the number of data points minus one (we do this to give the number of independent observations in the data set excluding the particular one you're looking at – look up degrees of freedom for more on this, but you don't need to worry too much about it),
- v) Calculate the square root of this total (you'll need the  $\sqrt{}$  or square root function on your calculator).

This will give you the standard deviation of the sample you're looking at (remember the bell curve representations of standard deviations around the mean – and the probabilities of a result falling within one, two or three standard deviations in hypothesis testing).

Back to our graph, imagine again expected return (y axis) and expected risk (x axis). Now imagine all of the stocks in the market dotted on the graph; some offer smaller returns for less risk, while others offer higher returns for higher risk and so on. Now imagine you draw a line around all the data dots, to give you the limits of the data (called the efficient frontier). Any point on this line represents the maximum and minimum risks and returns associated with the selection of individual stocks, and at some point on the line is the maximum return for the lowest risk for the diversified portfolio. This point reflects the ideal diversified portfolio of stocks and if you were to draw a line from the origin of the graph (the lefthand corner where  $y=0$  and  $x=0$ ) through this point, it would have a measurable slope to the line. The formula for the slope of a line is:

$$\text{Slope} = m = \frac{\Delta Y}{\Delta x}, \text{ or } m = \frac{\text{change in } Y}{\text{change in } X}, \text{ or } m = (Y_2 - Y_1) / (X_2 - X_1)$$

So, if  $x_2, y_2 = 4, 4$  and  $x_1, y_1 = 2, 2$ , then follow:

$$\text{Slope} = m = \frac{4-2}{4-2} = \frac{2}{2} = 1$$

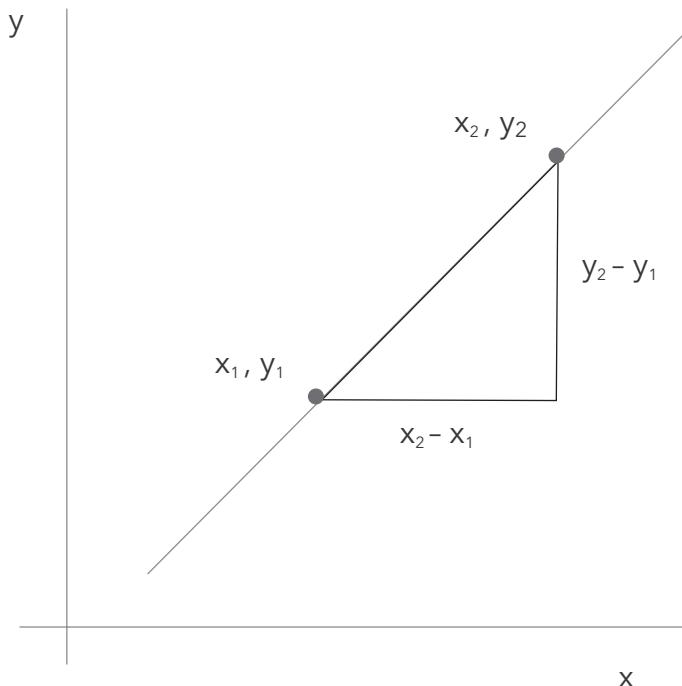
Sometimes you will see this represented as:

$$y = mx + b$$

Where,  $m$  = slope and  $b$  = intercept, or

$$y = \beta x + a$$

where  $\beta$  is the slope,  $a$  is the intercept (where it meets the y axis).



**Figure 5.2** The slope of a line is calculated by dividing the change in the y axis by the change in the x axis

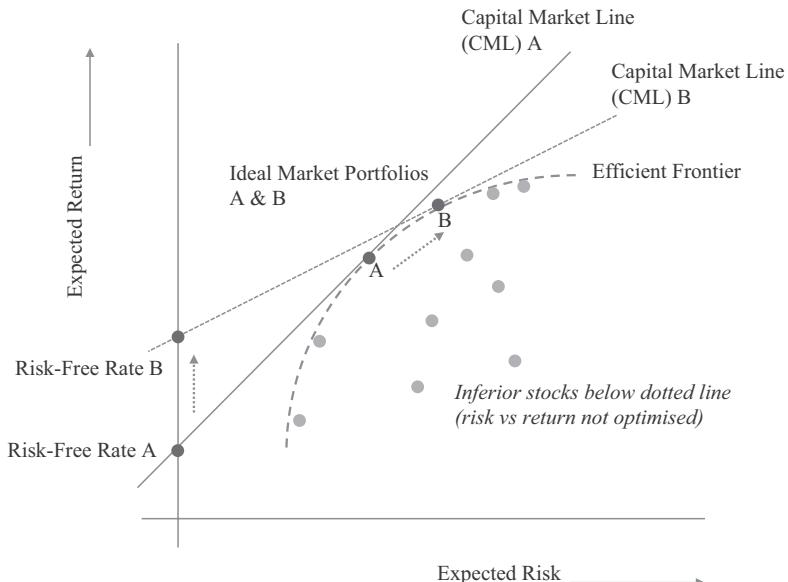
The slope of the line is called the portfolio beta ( $\beta_p$ ). If you were to draw lines from the origin through all the individual stock data dots, they would all have slopes with betas ( $\beta_i$ ). These betas can all be measured against the beta of the whole market ( $\beta_m$ ) to see if any one stock (or portfolio of stocks) is riskier or less risky than the whole market. More risky means a beta greater than one, less risky a beta of less than one. The final component to bear in mind and that ties us back into the impact of risk-free earnings, is that the risk-free (or base) earnings shift the origin of the graph (from 0,0) up the y axis by the amount of risk-free return offered. See all of this in Figure 5.3.

If you are more handy with formulas, CAPM looks like this:

$$\text{Expected Return of stock or investment} = \text{risk-free rate} + \text{beta of stock} \\ (\text{market risk premium})$$

Where the market risk premium is the expected market return – the risk-free rate. Or:

$$ERi = Rf + \beta_i (ERm - Rf)$$



**Figure 5.3** Illustrates the impact of increases in the risk-free price of money vs the 'Ideal Market Portfolio', the point at which the Efficient Frontier meets the CML (Capital Market Line) in the CAPM model. The CML is a line on a graph that represents the investment portfolios that offer the highest expected returns against the relative level of risk (beginning with the risk-free asset on the left, rising upwards to the right, as risk and the required returns increase).

In this way investors can see what returns they can expect from a stock or portfolio in return for the risks associated with that investment compared to the risk-free rate of return.

Back in the nuts and bolts of the time value of money, finance experts have developed a formula to calculate the future of money when starting with a known amount today, that goes:

Future Value ( $FV$ ) = Present Value ( $PV$ )  $\times$  (1 + Interest Rate ( $i$ )/number of compounding periods ( $n$ ) per year) to the power of  $n \times$  no. years ( $t$ )

Or

$$FV = PV \left(1 + \frac{i}{n}\right)^{nt}$$

If you want to get to a quarterly compounding calculation, replace  $n$  with 4, or monthly  $n$  with 12 etc. In an example for the FV of \$10,000, in 10 years' time when the interest rate was 10% this would look like:

$$FV = \$10,000 \left(1 + \frac{10\%}{1}\right)^{10}$$

So, the FV of \$10,000 (PV) is  $10,000 \times (1+0.1)^{10} = \$25,937$   
and if you do it in reverse:

$$PV = \left( \frac{25,937}{1 + \frac{10\%}{1}} \right)^{10}$$

Excel will do these calculations for you, just type =FV (or =PV (and insert the values for rate (%), n per (number of years), pmt (leave blank), and type (leave blank). *Note: both will deliver you negative figures because Excel thinks you have to make that payment to get the result it calculates.*

The reason we need to know FVs and PVs is so that we can compare the returns on different investments. Imagine you've got the choice of investing in your hospitality project or putting the same amount of money in the bank over 10 years, I'm guessing you'd like to know which will give you a better return on your investment, ideally that factors in the differing levels of risk.

## Discounted Cash Flows (DCFs)

If you're interested in calculating a perpetuity (an investment that pays out a never-ending flow of cash without eroding the principal) – quite useful if you want to know how much you might need in retirement – consider:

$$PV = \frac{\text{cash flow}}{(1 + i - cc)}$$

Where  $i$  is the interest rate and  $cc$  is the cost of capital. This can populate the following example equation:

*To earn \$80,000 per year in perpetuity, I divide \$80,000 by the discount rate, say 3% (which might be the interest rate less the cost of any borrowing e.g. interest rate I earn is 5% and the cost of my borrowing is 2% = 3%), the answer is \$2,666,667 i.e. I would need to invest \$2,666,667 today to get a payment of \$80,000 per year forever without eroding the original invested amount (assuming no changes in the interest rate % and cost of capital %).*

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Most firms will use WACC (the weighted average cost of capital) when they use the formula to value a cash flow as above. We will look at investment structuring shortly, but in summary:

- **Equity Investment:** the money shareholders put into the business for a share of its ownership; doesn't usually pay interest, but it does expect to see growth (otherwise why would you?), and it does have an opportunity cost, so the annual growth expectation might be, say 10–15% per year, and
- **Debt:** while it doesn't imply any ownership of the underlying company and so doesn't grow in value in line with the company's growth, it does usually cost the company interest, say 5% per annum.

The WACC therefore is the blended average of these two and conveniently also gives the RRR (required rate of return) that shareholders want in return for their investment. To calculate WACC, you simply multiply the percentages as follows:

Equity (say 15% return required) and equity accounts for 30% of the total capital needed.

Debt (say 5% interest rate) and debt accounts for the remaining 70% of the total capital needed.

Translates to:  $(15\% \times 30\%) + (5\% \times 70\%) = 4.5\% + 3.5\% = 8\%.$

Going back to the perpetuity, together  $(1 + i - cc)$  is known as the discount rate and we need to know this as we go into DCF analysis (discounted cash flow). DCF is simply the value of expected or projected future cash flows in today's money (or present value).

Imagine you build a restaurant that costs you \$1million (in year 0) and you expect to hold the investment for 10 years (you may refinance it then or you may sell it, but for the DCF we will assume you sell in year 10).

Consider, once it opens it is projected to make \$50,000 net profit in the first year (year 1), \$75,000 in the second year (year 2) and \$100,000 in the third year (year 3) and ongoing thereafter, as the business ramps up and then stabilises. First, we must translate these today values into future values (sometimes referred to as actual values, as opposed to present day values), which means factoring in inflation, say that's 2% per annum, so  $\$50,000 \text{ in year 1} = \$50,000 \times (1+0.02)^1 = \$51,000$ .  $\$75,000 \text{ in year 2} = 75,000 \times (1+0.02)^2 = \$78,030$  and  $\$100,000 \text{ in year 3} = 100,000 \times (1+0.02)^3 = \$106,121$  and so on at  $\$100,000 \times (1+0.02)^n$  until the end of the investment.

We now must discount all the projected future cash flows back to today's values to see what they are worth against the cost of the investment of \$1m. For this, let's use our 8% WACC as our discount rate (i.e. the rate we use to translate the future projected cash flows back to today's values). The final, element is to assign an estimated value of the restaurant upon sale in the 10<sup>th</sup> year (also in future values). For this we will also use the WACC of 8% as an exit or sale yield i.e. if the future value of the cash flow in year 10 is \$121,899 and that equals 8% of the capital value of the restaurant upon sale, it means the restaurant if valued at  $\$121,899 / 8\% = \$1.52m$  (which is included in the 10<sup>th</sup> year cash flow). Here it all is in table format:

Using this information, we can calculate the Net Present Value (NPV) of the cash flows (including the sale price). In Excel, you type =NPV (rate, value[s]), where rate is the WACC and values are all of the positive FV cash flows (so excluding the original investment of -\$1m), which returns an NPV of \$1,376,392, which is a \$376,392 profit on cost at today's values (38%) – not bad eh!

Now there is another way to value this cash flow that would mean we could compare it to other investments that had different risk profiles, and that is to conduct a calculation that includes the original investment and then returns a NPV of 0. In other words, what level of discount rate could you apply to the cash flows to return an exact match to the cost of the original investment? This is known as the internal rate of return (IRR) and in this case if we select an Excel cell and type =IRR(values, say10%) it gives us an IRR of 13%. This means you could change the

| Year | Income from Sale | Inflation  | WACC / Discount |               | PV of Future<br>Projected<br>Cash Flows |
|------|------------------|------------|-----------------|---------------|---|
|      |                  | 2%         | Rate            | 8%            |   |
| 0    |                  |            |                 | \$ -1,000,000 |   |
| 1    |                  | \$ 50,000  | \$ 51,000       | \$ 47,222     |   |
| 2    |                  | \$ 75,000  | \$ 78,030       | \$ 66,898     |   |
| 3    |                  | \$ 100,000 | \$ 106,121      | \$ 84,242     |   |
| 4    |                  | \$ 100,000 | \$ 108,243      | \$ 79,562     |   |
| 5    |                  | \$ 100,000 | \$ 110,408      | \$ 75,142     |   |
| 6    |                  | \$ 100,000 | \$ 112,616      | \$ 70,967     |   |
| 7    |                  | \$ 100,000 | \$ 114,869      | \$ 67,025     |   |
| 8    |                  | \$ 100,000 | \$ 117,166      | \$ 63,301     |   |
| 9    |                  | \$ 100,000 | \$ 119,509      | \$ 59,784     |   |
| 10   | \$ 1,523,738     | \$ 100,000 | \$ 1,645,637    | \$ 762,248    |   |

**Figure 5.4** Illustrating the 10-year future values of a cash flow of a business discounted back to today's values

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Discount Rate (or WACC) to 13% and walk away evens on the investment. Now we can compare the returns on different investments, like-for-like.

This is the way cash flows are valued around the world and the only real exceptions are when the periods are inconsistent or when you want to consider only the Return on Equity (in which case you strip out the cost of any debt from the cash flows or WACC) and run the same formulas.

### **Building a P&L (Profit and Loss Account)**

Now let's take a look at how to generate projections for all of the income and costs that sit above those nicely rounded Net Profits that translated into Cash Flows in our DCF example.

When I write a market and financial feasibility study for a hospitality project, I use my version of the Uniform System of Accounts for the Lodging Industry (US-ALI). The official current, 12<sup>th</sup> version of USALI was published in 2024 and will come into effect 2026. USALI is a global standard and is very easy to use and read for management accounting purposes.

We will go into this thoroughly, but in short, USALI presents Revenues by department, with Costs by department beneath (mostly variable costs i.e. they flex in direct proportion to the volume of business done), to give departmental operating profit, from which Undistributed costs (loosely, overhead or fixed costs) are then deducted to give a Gross Operating Profit (GOP) figure. The advantage of separating departments from each other and from the Undistributed expenses, is that you can quickly see which areas of the business need attention or support, which are driving income in comparison to the others, and which are making profits or losing money.

These are all the things that a manager (or management company) can effect in the course of day-to-day operations. Below, GOP are the costs that the manager cannot influence as easily, but which impact the business longer term and must be also be deducted in order to arrive at a Net Operating Profit figure which is the *clean* and *comparable* net operating profit of the business (sometimes called EBITDA, Earnings Before Interest Taxation Depreciation and Amortisation – the ITDA items are specific to the investor and the method of financing and are therefore outside the control of the manager). EBITDA is a universally recognised metric that allows analysts and business owners to compare returns on a like-for-like basis. USALI gives a standardised way to measure and compare performance of hospitality businesses around the world.

#### **Revenue**

To start, we need to get to a revenue figure by department for the hospitality business. There are two methods of doing this, *Fair Share* analysis and *Demand*

*Build-Up.* To illustrate, I will base an example of the fictitious Galleria Hotels, containing a Brewbakers Bistro. I will use fair share methodology to derive Rooms Revenue for Galleria and demand build-up to come up with figures for Food & Beverage Revenue. Fair share is when you quantify an existing market and see what happens when you insert a new hotel to it. Generally speaking, the fair share approach is only possible when you have a defined set of competitor hotels already in the location (that you can estimate the performance of with some degree of accuracy), and an established demand for hotels. By contrast, demand build-up tends to be used in locations where there is no existing supply or demand, or when the concept is completely different from anything else in the location. Demand build-up is precisely what it says: the estimation of demand based on building up estimated demand from different sources in layers to give a total annual demand figure. Because fair share uses notionally verifiable, existing data (purchased or estimated), it is typically thought to be the more robust of the two methods, although I have known projects funded off the back of reports using either. The secret, regardless of which process you deploy, is to create an income picture that is reasonable, logical and defensible in front of investors.

### **Rooms Revenue**

To use the fair share method, do an online search of hotels and draw up a list of properties you consider might be competitive (this might be on the basis of price, immediate location, quality level, range of facilities or demand generators/businesses or organisations that might be a source of demand).

Once you have done this, visit your chosen location (I've been doing this for 25+ years and I still typically spend at least three days in a location to get the true feel of it – don't rush this). Speak with hoteliers, people at Visitor Centres/Tourist Information Offices, and trade associations (as well as anyone else you can think of who knows the local hotel industry) to get as much information on bedroom occupancy and average room rate. Bedroom occupancy (number of bedrooms sold divided by the number of rooms available, in %) will typically show seasonality from weekday to weekend and throughout the year, depending on

| Competitor Hotels   | Number of Bedrooms | Total Occupancy | Annual Rooms Available | Annual Rooms Sold |
|---------------------|--------------------|-----------------|------------------------|-------------------|
| A                   | 150                | 76%             | 54,750                 | 41,454            |
| B                   | 100                | 75%             | 36,500                 | 27,531            |
| D                   | 175                | 72%             | 63,875                 | 45,990            |
| E                   | 200                | 75%             | 73,000                 | 54,541            |
| F                   | 125                | 81%             | 45,625                 | 36,826            |
| <b>Market Total</b> | <b>750</b>         | <b>75%</b>      | <b>273,750</b>         | <b>206,342</b>    |

**Figure 5.5** Showing five hotels in a competitive market where each is of a different size and has a different rate of occupancy that can be used to calculate the total size of demand in the market place

| Competitor Hotels | Food & Beverage       |                | Function Rooms           |                           |                         | Leisure |     |     | Other Car Parking Spaces |
|-------------------|-----------------------|----------------|--------------------------|---------------------------|-------------------------|---------|-----|-----|--------------------------|
|                   | Number of Restaurants | Number of Bars | Number of Function Rooms | Maximum Function Capacity | Smallest Event Capacity | Pool    | Spa | Gym |                          |
| A                 | 2                     | 2              | 8                        | 150                       | 10                      | ✓       | ✓   | ✓   | 100                      |
| B                 | 1                     | 1              | 5                        | 120                       | 12                      |         |     | ✓   | 75                       |
| D                 | 2                     | 2              | 10                       | 120                       | 10                      | ✓       | ✓   | ✓   | 125                      |
| E                 | 3                     | 4              | 12                       | 500                       | 8                       | ✓       | ✓   | ✓   | 150                      |
| F                 | 2                     | 3              | 6                        | 200                       | 5                       |         |     | ✓   | 85                       |

Figure 5.6 Shows the same five hotels with a schedule of facilities

location. Hint – you're going to need to know the size of all the hotels (number of bedrooms particularly and it is also important to get a list of facilities, pool, no. of restaurants, bars, etc.).

The other thing to find out is what the business mix is i.e. what percentage of total demand comes from which sectors e.g. 30% Individual Business, 15% MICE (meetings, incentives, conferences, & business events), 5% Aircrew and Other, 35% Individual Leisure, and 15% Weddings or Other Leisure Groups.

Once you have the market occupancy, you must apply growth factors by either weekday or weekend, or by demand segment (individual and group, for business and leisure at least) for the next five-ten years onwards from the date of your research (to allow for the time of construction of your project, its opening, on through to its demand stabilisation). In the same way, we must make allowance for what is called displaced demand (i.e. demand for hotel rooms in the competitive set that cannot be accommodated, because the hotels might be full on a particular night or they don't provide the facilities a guest wants, and therefore are displaced elsewhere outside the competitive set). Then we have to make allowance for estimates of any new demand that is going to be created in the future by your hotel that didn't come to the market before (by segment). Then we have to consider what a fair share of total demand looks like for your hotel and adjust by how we think your project is going to do compared to the rest of the market (again by segment). Finally, we have to make allowance for other hotels that might open (or close) during the period we're projecting for and adjust the supply of bedrooms accordingly.

Average Room Rate or Average Daily Rate (ARR or ADR), is the total rooms revenue divided by the number of rooms sold, and is the average price a room is sold for, net of sales tax (with sales tax removed). If you can't get actual data, you may wish to do an online *rate shop* of the online travel agents (OTAs) like Booking.com, Expedia, TripAdvisor, etc. (there is software that will do this for you, but it's expensive). This means gathering data on average room prices at competitor hotels on different dates (it can also help you select your competitors' hotels if you are unsure which ones to include – I always run a schedule of combined Excellent and Very Good scores, put into % for comparison, which is also useful in this regard). This, less the sales tax will typically reflect a room rate that is discounted

|  | %s     | Current Annual Rooms Sold | comments   | Future Years   |                |                |                |                |
|--|--------|---------------------------|--|----------------|----------------|----------------|----------------|----------------|
|  |        |                           |  | 1              | 2              | 3              | 4              | 5              |
| <b>Total Demand Segments</b>                           | 75%    | 206,342                   |  |                |                |                |                |                |
| <i>Indiv Business</i>                                  | 30%    | 61,903                    |  |                |                |                |                |                |
| <i>Group Business</i>                                  | 20%    | 41,268                    |  |                |                |                |                |                |
| <i>Indiv Leisure</i>                                   | 35%    | 72,220                    | <i>note how many nights are sold out in your rate shop</i> |                |                |                |                |                |
| <i>Group Leisure</i>                                   | 15%    | 30,951                    |  |                |                |                |                |                |
|  | 100%   | 206,342                   |  | 10,317         |                |                |                |                |
|  |        |                           | <b>Annual Growth</b>                                       |                |                |                |                |                |
| <i>Indiv Business</i>                                  | 30%    | 61,903                    | <i>in line with forecast GDP growth</i>                    | 3%             | 3%             | 3%             | 3%             | 3%             |
| <i>Group Business</i>                                  | 20%    | 41,268                    |  | 3%             | 3%             | 3%             | 3%             | 3%             |
| <i>Indiv Leisure</i>                                   | 35%    | 72,220                    | <i>in line with tourism growth</i>                         | 8%             | 6%             | 5%             | 3%             | 3%             |
| <i>Group Leisure</i>                                   | 15%    | 30,951                    |  | 8%             | 6%             | 5%             | 3%             | 3%             |
|  | 100%   | 206,342                   | <i>incl. Displaced</i>                                     | 228,008        | 238,269        | 247,799        | 255,233        | 262,890        |
|  |        |                           | <b>Created Demand</b>                                      |                |                |                |                |                |
| <i>Indiv Business</i>                                  | 30%    | 61,903                    |  | 500            | 800            | 1,000          | 1,000          | 1,000          |
| <i>Group Business</i>                                  | 20%    | 41,268                    | <i>additional demand created by your hotel</i>             |                |                |                |                |                |
| <i>Indiv Leisure</i>                                   | 35%    | 72,220                    |  |                |                |                |                |                |
| <i>Group Leisure</i>                                   | 15%    | 30,951                    |  |                |                |                |                |                |
|  | 100%   | 206,342                   |  | 500            | 800            | 1,000          | 1,000          | 1,000          |
| <b>Adjusted Total Demand</b>                           |        |                           |  | <b>228,508</b> | <b>239,069</b> | <b>248,799</b> | <b>256,233</b> | <b>263,890</b> |
|  |        |                           |  |                | <b>1</b>       | <b>2</b>       | <b>3</b>       | <b>4</b>       |
|  |        |                           |  |                |                |                |                | <b>5</b>       |
| <b>Room Supply Changes</b>                             |        |                           |  |                |                |                |                |                |
| <b>Your Hotel</b><br>(number of rooms/available rooms) | 100    |                           |  | 36,500         |                |                |                |                |
| <b>Other New Hotels</b>                                |        |                           |  |                |                |                |                |                |
| 1  | 40     |                           |  |                | 14,600         |                |                |                |
| 2  | 60     |                           |  |                | 21,900         |                |                |                |
| 3  |        |                           |  |                |                |                |                |                |
| <b>Total Rooms Available (Supply)</b>                  |        | 273,750                   |  | 310,250        | 346,750        | 346,750        | 346,750        | 346,750        |
| <b>Total Projected Rooms Sold (Demand)</b>             |        |                           |  | 228,508        | 239,069        | 248,799        | 256,233        | 263,890        |
| <b>Total Fair Share Occupancy</b>                      |        |                           |  | <b>74%</b>     | <b>69%</b>     | <b>72%</b>     | <b>74%</b>     | <b>76%</b>     |
| <b>Number of Hotels in the Market</b>                  | 5      |                           |  | 6              | 8              | 8              | 8              | 8              |
| <b>Average Size</b>                                    | 150    |                           |  | 142            | 119            | 119            | 119            | 119            |
| <b>Your Hotel</b>                                      | 100    |                           | <b>+/- Fair Share for your project</b>                     |                |                |                |                |                |
| <i>Indiv Business</i>                                  | 30%    |                           |  | 0%             | 3%             | 6%             | 8%             | 8%             |
| <i>Group Business</i>                                  | 20%    |                           | <i>How you will do compared to the market</i>              | 0%             | 3%             | 6%             | 8%             | 8%             |
| <i>Indiv Leisure</i>                                   | 35%    |                           |  | 0%             | 5%             | 6%             | 8%             | 8%             |
| <i>Group Leisure</i>                                   | 15%    |                           |  | 0%             | 5%             | 6%             | 8%             | 8%             |
|  | 100%   |                           |  | <b>0%</b>      | <b>4%</b>      | <b>6%</b>      | <b>8%</b>      | <b>8%</b>      |
| <b>Projected Rooms Available</b>                       | 36,500 |                           |  | 36,500         | 36,500         | 36,500         | 36,500         | 36,500         |
| <b>Projected Rooms Sold</b>                            |        |                           |  | 26,883         | 26,503         | 28,379         | 29,892         | 30,698         |
| <b>Projected Occupancy</b>                             |        |                           |  | <b>73.7%</b>   | <b>72.6%</b>   | <b>77.8%</b>   | <b>81.9%</b>   | <b>84.1%</b>   |

**Figure 5.7** Shows how the total market size must be adjusted into the future to reflect growth patterns, displaced demand and the competitive position of our project and its relative performance.

Sales Tax Rate 20%

| Competitor Hotels |  | Average Published Tariff Week "1" (beginning 3/3/25)  |          |           |          |          |          |          |          |
|-------------------|--|---|----------|-----------|----------|----------|----------|----------|----------|
|                   |  | Monday  | Tuesday  | Wednesday | Thursday | Friday   | Saturday | Sunday   | Average  |
| A                 |  | € 85.00   | € 85.00  | € 85.00   | € 85.00  | € 65.00  | € 65.00  | € 60.00  | € 91.96  |
| B                 |  | € 90.00   | € 95.00  | € 98.00   | € 95.00  | € 75.00  | € 75.00  | € 65.00  |          |
| D                 |  | € 110.00  | € 115.00 | € 115.00  | € 115.00 | € 95.00  | € 95.00  | € 80.00  |          |
| E                 |  | € 105.00  | € 108.00 | € 110.00  | € 110.00 | € 109.00 | € 100.00 | € 85.00  |          |
| F                 |  |   |          |           |          |          |          |          |          |
| Competitor Hotels |  | Average Published Tariff Week "2" (beginning 14/4/25) |          |           |          |          |          |          |          |
|                   |  | Monday  | Tuesday  | Wednesday | Thursday | Friday   | Saturday | Sunday   |          |
| A                 |  | € 95.00   | € 95.00  | € 95.00   | € 95.00  | € 125.00 | € 125.00 | € 125.00 | € 117.48 |
| B                 |  | € 105.00  | € 110.00 | € 112.00  | € 110.00 | € 125.00 | € 125.00 | € 125.00 |          |
| D                 |  | € 120.00  | € 125.00 | € 125.00  | € 125.00 | € 135.00 | € 135.00 | € 135.00 |          |

**Figure 5.8** Showing an example of an online rate shop

off the published tariff to the tune of 15–25%. Top tip: consider that in most situations, OTA sales account for 40–50% of bookings and the remainder are direct with the hotel (50–60%). The average cost for the hotel to run its website, email marketing and all the other direct booking tools is around 5–10%. So, if you rate shop the hotels' own websites as well as the OTAs, deduct the sales tax from all results, and then apply a 25% discount to 50% of bookings (to reflect OTA bookings) and a 5% discount to 50% of bookings (to reflect direct bookings), you get to a blended average discount of 15%, which if you apply to the average published tariffs from your rate shop, will bring you pretty close to the hotel's ARR as a double check against what you've been told. Just remember to be consistent in your search and select the published rates for a standard double room and then strip out the sales tax. In your search, select sample rates for every day of a whole week at a time, and select weeks at different times of the year, to get a clearer picture. You will start to notice patterns: when are they more expensive? Weekdays or weekends? Summers and holiday periods, or prime business months?

Ask local hotel operators – it's the best way to get the information you want (using some of the skills from earlier in the book). If you can't get details, get generalities; if you can't get generalities, you're going to have to make estimates based on what you observe, by using proxies for the information, or anything else you can. Getting the information direct from the horse's mouth is still the best and cheapest way (you'll also be more likely to pick up on the subtle nuances of the local market that will not be revealed by any official reports or pure statistics databases).

Once you have your information, tabulate it in Excel/a spreadsheet and estimate your ARR.

Now you have your ARR and Occupancy projections we can put them into your P&L.

| Year                                 | 1          | -             | Rooms Available / Year           | Room Type Mix        | Published Tariffs        | Average Discount %        | ARR                     |
|--------------------------------------|------------|---------------|----------------------------------|----------------------|--------------------------|---------------------------|-------------------------|
| <b>This Project</b>                  |            |               |                                  |                      |                          |                           |                         |
| Total # Suites                       | 5          | 1,825         | 5%                               | € 180.00             | 35%                      |                           |                         |
| Total # of Deluxe Rooms              | 15         | 5,475         | 15%                              | € 150.00             |                          |                           |                         |
| Total # of Standard King Rooms       | 40         | 14,600        | 40%                              | € 125.00             |                          |                           |                         |
| Total # of Standard Double Rooms     | 40         | 14,600        | 40%                              | € 120.00             |                          |                           |                         |
| <b>Total # of Rooms &amp; Suites</b> | <b>100</b> | <b>36,500</b> | <i>(weighted average tariff)</i> | <b>€ 129.50</b>      | <b>€ 45.33</b>           | <b>€ 84.18</b>            | <i>(Today's Values)</i> |
| <b>This Project</b>                  | <b>2</b>   | <b>-</b>      | <b>Rooms Available / Year</b>    | <b>Room Type Mix</b> | <b>Published Tariffs</b> | <b>Average Discount %</b> | <b>ARR</b>              |
| Total # Suites                       | 5          | 1,825         | 5%                               | € 180.00             | 32%                      |                           |                         |
| Total # of Deluxe Rooms              | 15         | 5,475         | 15%                              | € 150.00             |                          |                           |                         |
| Total # of Standard King Rooms       | 40         | 14,600        | 40%                              | € 125.00             |                          |                           |                         |
| Total # of Standard Double Rooms     | 40         | 14,600        | 40%                              | € 120.00             |                          |                           |                         |
| <b>Total # of Rooms &amp; Suites</b> | <b>100</b> | <b>36,500</b> | <i>(weighted average tariff)</i> | <b>€ 129.50</b>      | <b>€ 41.44</b>           | <b>€ 88.06</b>            | <i>(Today's Values)</i> |
| <b>This Project</b>                  | <b>3</b>   | <b>-</b>      | <b>Rooms Available / Year</b>    | <b>Room Type Mix</b> | <b>Published Tariffs</b> | <b>Average Discount %</b> | <b>ARR</b>              |
| Total # Suites                       | 5          | 1,825         | 5%                               | € 180.00             | 30%                      |                           |                         |
| Total # of Deluxe Rooms              | 15         | 5,475         | 15%                              | € 150.00             |                          |                           |                         |
| Total # of Standard King Rooms       | 40         | 14,600        | 40%                              | € 125.00             |                          |                           |                         |
| Total # of Standard Double Rooms     | 40         | 14,600        | 40%                              | € 120.00             |                          |                           |                         |
| <b>Total # of Rooms &amp; Suites</b> | <b>100</b> | <b>36,500</b> | <i>(weighted average tariff)</i> | <b>€ 129.50</b>      | <b>€ 38.85</b>           | <b>€ 90.65</b>            | <i>(Today's Values)</i> |

**Figure 5.9** Showing an average rate calculation table, using average published tariffs and then discounting them by a market average rate to achieve a projected ARR (average room rate)

| Year                                       | 1              |
|--|----------------|
| Rooms Available                            | 36,500         |
| Rooms Sold                                 | 26,883         |
| <b>Room Occupancy</b>                      | <b>73.7%</b>   |
| <b>Average Room Rate</b>                   | <b>€ 88.38</b> |
| <i>Revenue per Available Room (RevPAR)</i> | <b>€ 65.10</b> |
| <b>REVENUES</b>                            | <b>€</b>       |
| Rooms                                      | 2,376,049      |

**Figure 5.10** How available and sold rooms feed into occupancy (%)

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Proposed Galleria Hotel (with Brewbaker's Bistro)  
5 Year Pro-Forma Profit & Loss Statement

| Actual Year Values                  |           |    |             |                   |                   | Exhibit 1         |                   |  |
|-------------------------------------|-----------|----|-------------|-------------------|-------------------|-------------------|-------------------|--|
|                                     | Inflation | 5% |             | 100               | Letting Units     |                   |                   |  |
| Year                                |           |    | 1           | 2                 | 3                 | 4                 | 5                 |  |
| Rooms Available                     |           |    | 36,500      | 36,500            | 36,500            | 36,500            | 36,500            |  |
| Rooms Sold                          |           |    | 26,883      | 26,503            | 28,379            | 29,892            | 30,698            |  |
| Room Occupancy                      |           |    | 73.7%       | 72.6%             | 77.8%             | 81.9%             | 84.1%             |  |
| Average Room Rate                   | €         |    | 88.38       | € 97.09           | € 104.94          | € 110.19          | € 115.69          |  |
| Revenue per Available Room (RevPAR) | €         |    | 65.10       | € 70.50           | € 81.59           | € 90.24           | € 97.30           |  |
| REVENUES                            | €         | £  | £ 2,376,049 | £ 52% € 2,573,118 | £ 51% € 2,978,098 | £ 53% € 3,293,662 | £ 54% € 3,551,595 |  |
| Rooms                               | €         |    |             |                   |                   |                   |                   |  |

**Figure 5.11** Demonstrating how the figures calculated so far feed into the first few lines of a Profit and Loss Account

### Food and Beverage Revenue

With hotels and guest houses (overnight hospitality accommodation providers), a large proportion of total revenue comes from residents in terms of the money they spend on the room (ARR). They will also spend money in the restaurants and bars (aka food and beverage, or F&B), as well as at the other facilities, which we need to capture for our P&L. Then there are non-residents (aka chance spend or passing trade) who will also generate revenue for the property. Our Galleria Hotel example has both residents and non-residents using the food and beverage facilities. Everyone will use the Brewbaker's Bistro for the main service periods (breakfast, lunch, dinner, morning coffees and afternoon teas + function catering), while only residents will use room service and minibar. We will use data from our rooms' fair share analysis to calculate likely F&B uptake

| Restaurant Covers (seats) 80 |              |                     |                         |                   |                  |           |           |
|------------------------------|--------------|---------------------|-------------------------|-------------------|------------------|-----------|-----------|
| Residents                    | Mix          | Rooms Sold (Year 1) | Double Occupancy Factor | Residents by Type |                  |           |           |
| Indiv Business               | 30%          | 8,065               | 1.1                     | 8,871             |                  |           |           |
| Group Business               | 20%          | 5,377               | 1.1                     | 5,914             |                  |           |           |
| Indiv Leisure                | 35%          | 9,409               | 1.6                     | 15,055            |                  |           |           |
| Group Leisure                | 15%          | 4,032               | 1.4                     | 5,645             |                  |           |           |
|                              |              | 26,883              | 1.3                     | 35,486            |                  |           |           |
| Service Periods              | Room Service | Breakfast           | Morning Snacks          | Lunch             | Afternoon Snacks | Dinner    | TOTAL     |
| Average Spend                | € 19.20      | € 14.40             | € 7.68                  | € 19.20           | € 7.68           | € 24.00   |           |
| Net of Sales Tax             | € 16.00      | € 12.00             | € 6.40                  | € 16.00           | € 6.40           | € 20.00   |           |
| Uptake                       |              |                     |                         |                   |                  |           |           |
| Indiv Business               | 2%           | 50%                 | 5%                      | 30%               | 5%               | 40%       |           |
| Group Business               | 2%           | 100%                | 5%                      | 100%              | 5%               | 100%      |           |
| Indiv Leisure                | 2%           | 85%                 | 15%                     | 20%               | 15%              | 70%       |           |
| Group Leisure                | 2%           | 100%                | 5%                      | 100%              | 5%               | 100%      |           |
| Residential Uptake           | 538          | 17,408              | 2,366                   | 9,678             | 2,083            | 15,189    |           |
| Residential Revenue          | € 8,603      | € 208,900           | € 15,141                | € 154,848         | € 13,334         | € 303,782 | € 704,607 |
| average daily usage          | 1            | 48                  | 6                       | 27                | 6                | 42        |           |

**Figure 5.12** Shows how demand is built up in a model by making assumptions regarding the percentage of residents who will attend

|   |              |                      |                     |                      |                     |                      |             |
|---|--------------|----------------------|---------------------|----------------------|---------------------|----------------------|-------------|
| Residential Revenue<br>average daily usage    | € 8,603      | € 208,900            | € 15,141            | € 154,848            | € 13,334            | € 303,782            | € 704,607   |
| Non-Residents                                 | Room Service | Breakfast            | Morning Snacks      | Lunch                | Afternoon Snacks    | Dinner               | TOTAL       |
| Average Net Spends<br>Service Periods         | N/A          | € 12.00<br>0700-0930 | € 6.40<br>1000-1200 | € 16.00<br>1230-1430 | € 6.40<br>1500-1700 | € 20.00<br>1800-2130 |             |
| Trading Hours                                 |              | 2.5                  | 2                   | 2                    | 2                   | 3.5                  |             |
| Walk-Ins per Hour                             |              | 5                    | 10                  | 15                   | 10                  | 20                   |             |
| Total Walk-ins per Service                    |              | 13                   | 20                  | 30                   | 20                  | 70                   |             |
| Total Non-Resident Revenue                    | € -          | € 54,750             | € 46,720            | € 175,200            | € 46,720            | € 511,000            | € 834,390   |
| Combined Resident & Non-Resident Food Revenue | € 8,603      | € 263,650            | € 61,861            | € 330,048            | € 60,054            | € 814,782            | € 1,538,997 |

**Figure 5.13** Shows how demand is built up in a model by making assumptions regarding the percentage of residents who will attend and how many non-resident guests will visit

for residents and a build-up model for non-residents. First, residents' food consumption at Brewbakers + room service (where we have to calculate the resident daily population, by applying a double occupancy factor to the rooms sold, then estimating uptake by market segment and then assigning an average spend (net of sales tax).

Then, we have to build up demand at Brewbakers Bistro. Incidentally, we have to have enough seats (covers) in the restaurant to accommodate residents and non-residents alike (this doesn't have to be one for one, but at the concept planning stage we should make reasonable allowances). We have assumed an 80-seat restaurant.

This gives us our F&B revenue, which we can now add into our P&L. Now we could do exactly the same exercise for beverage spends, but for the sake of simplicity, we will just assume that beverage sales account for an average of 25% of food sales. We have used data on the first year's bedroom occupancy figures to calculate residential uptake, so we should grow this figure, along with our non-residents in real terms as well as allowing for inflation. We will assume 5% growth Year 1-2 (+ inflation), 3% Year 2-3 (+ inflation) and 0% thereafter (+ inflation).

We also need to make allowance for meetings and events (conferences and banqueting), which we have assumed for simplicity is only residents, and the food revenue is therefore captured in the tables above under Group Business and Group Leisure (which is why we show it as 100% uptake – equivalent to around 26 residents per day, around half of whom will not be attending functions, but will be on package deals). Room Hire Fees are calculated as part of Rental and Other Income (which we'll get to shortly).

The result looks like this in the P&L in Figure 5.14.

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### Proposed Galleria Hotel (with Brewbaker's Bistro) 5 Year Pro-Forma Profit & Loss Statement

| Actual Year Values                  |             |          |             |          | Exhibit 1         |          |             |          |             |
|-------------------------------------|-------------|----------|-------------|----------|-------------------|----------|-------------|----------|-------------|
| Inflation 5%                        |             |          |             |          | 100 Letting Units |          |             |          |             |
| Year                                | 1           | 2        | 3           | 4        | 5                 |          |             |          |             |
| Rooms Available                     | 36,500      | 36,500   | 36,500      | 36,500   | 36,500            |          |             |          |             |
| Rooms Sold                          | 26,883      | 26,503   | 28,379      | 29,892   | 30,698            |          |             |          |             |
| <b>Room Occupancy</b>               | 73.7%       | 72.6%    | 77.8%       | 81.9%    | 84.1%             |          |             |          |             |
| Average Room Rate                   | € 88.38     | € 97.09  | € 104.94    | € 110.19 | € 115.69          |          |             |          |             |
| Revenue per Available Room (RevPAR) | € 65.10     | € 70.50  | € 81.59     | € 90.24  | € 97.30           |          |             |          |             |
| <b>REVENUES</b>                     | <b>£</b>    | <b>%</b> | <b>£</b>    | <b>%</b> | <b>£</b>          | <b>%</b> | <b>£</b>    | <b>%</b> | <b>£</b>    |
| Rooms                               | € 2,376,049 | 52%      | € 2,573,118 | 51%      | € 2,978,098       | 53%      | € 3,293,662 | 54%      | € 3,551,595 |
| Brewbakers Food                     | € 1,538,997 |          | € 1,692,897 |          | € 1,828,329       |          | € 1,919,745 |          | € 2,015,732 |
| Brewbakers Bar                      | € 384,749   |          | € 423,224   |          | € 457,082         |          | € 479,936   |          | € 503,933   |
| Total Brewbakers                    | € 1,923,747 | 42%      | € 2,116,121 | 42%      | € 2,285,411       | 41%      | € 2,399,681 | 39%      | € 2,519,666 |

**Figure 5.14** An illustration of how our food and beverage calculations feed into the P&L

## Leisure

For Leisure, we will assume there is a spa and gym, available for free to residents and with an external membership, as follows in Figure 5.15.

The above figures are inserted into the P&L and inflated to future values (allowing for inflation).

## Minor Operated Departments

Or MODs as they are often called, are the combined revenues from much smaller departments. Historically, this might have included telephone charges, laundry and business centre, but you can use MODs as your catch-all (or the spot to put anything of relatively low income that doesn't belong anywhere else). Again for simplicity, I tend to use a flat % of rooms sold, multiplied by an average spend figure (using information gathered from my field research). Let's say €10 average spend for laundry and business centre (copies, printing etc.) with an uptake by 2% of the rooms sold. This gives a pretty small amount that is almost not worth adding as a separate line, but have done to demonstrate.

## Rental and Other Income

Or ROI. This is where you put any income from commissions and concessions (things like foreign currency exchange, or booking theatre tickets, etc.), as well as any rent you charge for space in the hotel (like a jewellery stand in the lobby,

| Spa & Gym                          |   | Today's Price    |                  | Residential Uptake |                  | 710              | 2%               |
|------------------------------------|---|------------------|------------------|--------------------|------------------|------------------|------------------|
| Joining Fee                        |   | € 30             |                  |                    |                  |                  |                  |
| Monthly Subscription               |   | € 30             |                  |                    |                  |                  |                  |
| Annual Subscription                |   | € 360            |                  |                    |                  |                  |                  |
| Year                               | 1 | 2                | 3                | 4                  | 5                |                  |                  |
| <i>Membership Churn</i>            |   | 20%              |                  | 20%                |                  | 20%              |                  |
| New Members                        |   | 200              |                  | 40                 |                  | 40               |                  |
| Joining Fees                       |   | € 6,000          | € 1,200          | € 1,200            | € 1,200          | € 1,200          | € 1,200          |
| <i>Membership Growth</i>           |   | 15%              |                  | 5%                 |                  |                  |                  |
| Memberships                        |   | 200              |                  | 230                |                  | 240              |                  |
| Membership Subs                    |   | € 72,000         | € 82,800         | € 86,400           | € 86,400         | € 86,400         | € 86,400         |
| <b>Total Membership Revenue</b>    |   | <b>€ 78,000</b>  | <b>€ 84,000</b>  | <b>€ 87,600</b>    | <b>€ 87,600</b>  | <b>€ 87,600</b>  | <b>€ 87,600</b>  |
| Average Weekly Visits per Member   |   |                  |                  |                    |                  |                  |                  |
| Average Daily Member Population    |   |                  |                  |                    |                  |                  |                  |
| Average Resident Population        |   |                  |                  |                    |                  |                  |                  |
| Total Daily Population             |   | 45               | 51               | 53                 | 53               | 53               | 53               |
| Average Uptake for Treatments      |   |                  |                  |                    |                  |                  |                  |
| Average Uptake for Treatments      |   |                  |                  |                    |                  |                  |                  |
| Average Treatment Price            |   | € 35.00          |                  |                    |                  |                  |                  |
| <b>Total Treatment Revenue</b>     |   | <b>€ 85,626</b>  | <b>€ 97,911</b>  | <b>€ 102,006</b>   | <b>€ 102,006</b> | <b>€ 102,006</b> | <b>€ 102,006</b> |
| <b>Total Spa &amp; Gym Revenue</b> |   | <b>€ 163,626</b> | <b>€ 181,911</b> | <b>€ 189,606</b>   | <b>€ 189,606</b> | <b>€ 189,606</b> | <b>€ 189,606</b> |

**Figure 5.15** Build-up of revenue for a spa and gym outlet with membership and treatment income

etc.). I use 5% of rooms revenue as a rule of thumb (which somehow always turns out to be just as accurate as another part of the projection!).

Voila! The revenue part of our P&L is complete and looks like this:

Now we will go on to the departmental expenses, which you'll be relieved to know are generally much simpler.

First up:

### Cost of Sales

Literally the raw materials of the department – food and drinks, etc. The only odd one, is rooms department, which doesn't have cost of sales (because it is the room itself, which is of course a capital item not an operating cost – before you say what about cleaning materials? etc., those come under Direct Expenses). Because they're relatively simple, we can use percentages of revenue to calculate Cost of Sales. With F&B, the Departmental Revenue less Cost of Sales % is often referred to as the GP (or Gross Profit, and definitely not to be confused with Gross Operating Profit coming up shortly). Chain operators will check the GPs of their multiple outlets every Monday morning and if the GP appears to be out by more than 2% they will start an investigation. I will illustrate Cost of Sales

## **Proposed Galleria Hotel (with Brewbaker's Bistro) 5 Year Pro-Forma Profit & Loss Statement**

| Actual Year Values                         |                    |         |                    | Exhibit 1 |                    |      |                    |      |                    |
|--|--------------------|---------|--------------------|-----------|--------------------|------|--------------------|------|--------------------|
| Inflation                                  | 5%                 |         |                    | 100       | Letting Units      |      |                    |      |                    |
| Year                                       | 1                  | 2       | 3                  | 4         | 5                  |      |                    |      |                    |
| Rooms Available                            | 36,500             | 36,500  | 36,500             | 36,500    | 36,500             |      |                    |      |                    |
| Rooms Sold                                 | 26,883             | 26,503  | 28,379             | 29,892    | 30,698             |      |                    |      |                    |
| <b>Room Occupancy</b>                      | 73.7%              | 72.6%   | 77.8%              | 81.9%     | 84.1%              |      |                    |      |                    |
| <b>Average Room Rate</b>                   | € 88.38            | € 97.09 | € 104.94           | € 110.19  | € 115.69           |      |                    |      |                    |
| <b>Revenue per Available Room (RevPAR)</b> | € 65.10            | € 70.50 | € 81.59            | € 90.24   | € 97.30            |      |                    |      |                    |
| <b>REVENUES</b>                            | £                  | £       | £                  | £         | £                  |      |                    |      |                    |
| Rooms                                      | € 2,376,049        | 52%     | € 2,573,118        | 51%       | € 2,798,098        | 53%  | € 3,293,662        | 54%  | € 3,551,595        |
| Brewbakers Food                            | € 1,538,997        |         | € 1,692,897        |           | € 1,828,329        |      | € 1,919,745        |      | € 2,015,732        |
| Brewbakers Bar                             | € 384,749          |         | € 423,224          |           | € 457,082          |      | € 479,936          |      | € 503,933          |
| Total Brewbakers                           | € 1,923,747        | 42%     | € 2,116,121        | 42%       | € 2,285,411        | 41%  | € 2,399,681        | 39%  | € 2,519,666        |
| Leisure                                    | € 171,807          | 4%      | € 209,041          | 4%        | € 219,493          | 4%   | € 230,467          | 4%   | € 241,991          |
| Minor Operated Departments                 | € 5,645            | 0%      | € 5,844            | 0%        | € 6,571            | 0%   | € 7,267            | 0%   | € 7,836            |
| Rental & Other Income                      | € 118,802          | 3%      | € 128,656          | 3%        | € 148,905          | 3%   | € 164,683          | 3%   | € 177,580          |
| <b>Total</b>                               | <b>€ 4,596,051</b> | 100%    | <b>€ 5,032,780</b> | 100%      | <b>€ 5,638,477</b> | 100% | <b>€ 6,095,760</b> | 100% | <b>€ 6,498,667</b> |

**Figure 5.16** Illustrating the revenue component of our P&L

on the P&L at the end of Departmental Expenses. There is some debate around whether online travel agents (OTA) commissions should be included as a cost of sales for rooms, but I'm old school and consider these costs should be considered as part of the marketing budget. Lastly, ROI has no cost of sales associated with it for obvious reasons.

## Direct Expenses

As indicated, these are all of the consumables that are used to clean, prepare and serve the department's offering (not including the raw materials, obviously). These typically include napkins, soaps, washing up liquid, etc., things that the volume used is directly linked to the number of customers served. Again, ROI has no Direct Expenses Associated with it. I will illustrate Direct Expenses on the P&L at the end of Departmental Expenses.

## Payroll

Payroll is a little trickier (or more time-consuming), but when you break it down it's really just a logical process.

First let's start with an assumed overall salaries summary as shown in Figure 5.17.

Now let's work up the figures by sub-department, beginning with housekeeping (follow the logic) as shown in Figure 5.18.

Now for Front Office and Reservations (shown in Figure 5.19).

And the same approach for restaurant, bar and kitchen (Figure 5.20).

**Salaries****Junior Staff**

|              |         |                             |
|--------------|---------|-----------------------------|
| Min Wage     | € 10.00 |                             |
|              | 13.80%  | Employers Tax Contributions |
|              | 7.50%   | Hols, Pension & Bens        |
|              | 1.20%   | Uniform/meals/training      |
|              | 22.50%  |                             |
| Total Hourly | € 2.25  |                             |
|              | € 12.25 |                             |

**Supervisors /Junior****Managers**

|         |         |  |
|---------|---------|--|
| Premium | 40.00%  |  |
|         | € 17.15 |  |

**Figure 5.17** Shows the salary assumptions going into our model**Housekeeping**

|                                     |                  |                                     |
|-------------------------------------|------------------|-------------------------------------|
| if                                  | 1                | hskpr cleans                        |
|                                     | 8                | hrs/day                             |
|                                     | 5                | shifts/week                         |
|                                     | 48               | weeks/year                          |
|                                     | 1920             | hours/year                          |
|                                     | 40               | hours/week                          |
| <i>Junior Staff</i>                 | € 23,520         | <i>annual salary equivalent</i>     |
| <i>Supervisors /Junior Managers</i> | € 32,928         | <i>annual salary equivalent</i>     |
| if they clean                       | 2.5              | rooms/hr                            |
| they clean                          | 4800             | rooms/year                          |
| and rooms/year                      | 26,883           | need servicing                      |
| so                                  | 6                | staff are needed to cover           |
|                                     | 20.00%           | <i>Supervisors to Juniors Ratio</i> |
| Supervisors                         | 1                |                                     |
| <b>Payroll Cost</b>                 | <b>€ 164,656</b> |                                     |
|                                     | € 6.12           | Cost/Room Equivalent                |

**Figure 5.18** Shows the assumptions for the number of staff in housekeeping going into our model

**Front Office &  
Reservations**

|                                     |                  |                                 |
|-------------------------------------|------------------|---------------------------------|
| if                                  | 1                | works                           |
|                                     | 8                | hours/shift                     |
|                                     | 5                | shifts/week                     |
|                                     | 48               | weeks/year                      |
| they work                           | 1920             | hours/year                      |
|                                     | 40               | hours/week                      |
| <i>Junior Staff</i>                 | £ 23,520         | <i>annual salary equivalent</i> |
| <i>Supervisors /Junior Managers</i> | £ 32,928         | <i>annual salary equivalent</i> |
| If                                  | 2                | Desk is open                    |
| for                                 | 16               | hours/day (0700-2300)           |
| for                                 | 365              | days/year                       |
| it requires                         | 11680            | hours cover                     |
| so                                  | 6                | staff are needed to cover       |
| Supers to Juniors                   | 20.00%           |                                 |
|                                     | 1                |                                 |
| <b>Payroll Cost</b>                 | <b>£ 174,048</b> |                                 |
| <b>Total FO</b>                     | <b>£ 338,704</b> |                                 |

**Figure 5.19** Shows the assumptions for the number of staff in front office and reservations going into our model

**F&B Front of House**
**F&B Back of House**

|                                     |                  |                                 |                                     |                  |                                 |
|-------------------------------------|------------------|---------------------------------|-------------------------------------|------------------|---------------------------------|
| if                                  | 1                | works                           | if                                  | 1                | works                           |
|                                     | 8                | hours/shift                     |                                     | 8                | hours/shift                     |
|                                     | 5                | shifts/week                     |                                     | 5                | shifts/week                     |
|                                     | 48               | weeks/year                      |                                     | 48               | weeks/year                      |
| they work                           | 1920             | hours/year                      | they work                           | 1920             | hours/year                      |
|                                     | 40               | hours/week                      |                                     | 40               | hours/week                      |
| <i>Junior Staff</i>                 | £ 23,520         | <i>annual salary equivalent</i> | <i>Junior Staff</i>                 | £ 23,520         | <i>annual salary equivalent</i> |
| <i>Supervisors /Junior Managers</i> | £ 32,928         | <i>annual salary equivalent</i> | <i>Supervisors /Junior Managers</i> | £ 32,928         | <i>annual salary equivalent</i> |
| If                                  | 4                | service stations is open        | If                                  | 4                | service stations is open        |
| for                                 | 16               | hours/day (0700 -2300)          | for                                 | 16               | hours/day (0700 -2300)          |
| for                                 | 365              | days/year                       | for                                 | 365              | days/year                       |
| it requires                         | 23360            | hours cover                     | it requires                         | 23360            | hours cover                     |
| so                                  | 12               | staff are needed to cover       | so                                  | 12               | staff are needed to cover       |
|                                     | 20.00%           |                                 |                                     | 20.00%           |                                 |
|                                     | 2                |                                 |                                     | 2                |                                 |
| <b>Payroll Cost</b>                 | <b>£ 348,096</b> |                                 | <b>Payroll Cost</b>                 | <b>£ 348,096</b> | <b>TOTAL F&amp;B</b>            |
|                                     |                  |                                 |                                     |                  | <b>£ 696,192</b>                |

**Figure 5.20** Shows the assumptions for the number of staff in F&B going into our model

Now we can add these to the P&L to get Departmental Profits (before overhead costs). We will come on to the General Manager, Sales & Marketing, Maintenance Team, etc. shortly.

I have used ratios to populate the payroll figures for Leisure and MODs, and sense checked them for reasonableness.

So, there you are, that is the bulk of the P&L done. Now let's finish the rest of it, starting with Undistributed Expenses.

## Undistributed Expenses

Undistributed Expenses are broadly speaking, the overhead costs that don't really flex with the amount of business that you do. They are as follows: Admin & General payroll and expenses (GM and senior management salaries that are

### Proposed Galleria Hotel (with Brewbaker's Bistro)

#### 5 Year Pro-Forma Profit & Loss Statement

| Actual Year Values                  |                    |              |                    |              |                    |             |                    |             |                    | Exhibit 1         |  |
|-------------------------------------|--------------------|--------------|--------------------|--------------|--------------------|-------------|--------------------|-------------|--------------------|-------------------|--|
| Inflation 5%                        |                    |              |                    |              |                    |             |                    |             |                    | 100 Letting Units |  |
| Year                                | 1                  | 2            | 3                  | 4            | 5                  |             |                    |             |                    |                   |  |
| Rooms Available                     | 36,500             | 36,500       | 36,500             | 36,500       | 36,500             |             |                    |             |                    | 36,500            |  |
| Rooms Sold                          | 26,883             | 26,503       | 28,379             | 29,892       | 29,892             |             |                    |             |                    | 29,892            |  |
| <b>Room Occupancy</b>               | <b>73.7%</b>       | <b>72.6%</b> | <b>77.8%</b>       | <b>81.9%</b> | <b>84.1%</b>       |             |                    |             |                    |                   |  |
| Average Room Rate                   | £ 88.38            | £ 97.09      | £ 104.94           | £ 110.19     | £ 115.69           |             |                    |             |                    |                   |  |
| Revenue per Available Room (RevPAR) | £ 65.10            | £ 70.50      | £ 81.59            | £ 90.24      | £ 97.30            |             |                    |             |                    |                   |  |
| <b>REVENUES</b>                     | <b>£</b>           | <b>%</b>     | <b>£</b>           | <b>%</b>     | <b>£</b>           | <b>%</b>    | <b>£</b>           | <b>%</b>    | <b>£</b>           | <b>%</b>          |  |
| Rooms                               | £ 2,376,049        | 52%          | £ 2,573,118        | 51%          | £ 2,978,098        | 53%         | £ 3,293,662        | 53%         | £ 3,551,595        | 55%               |  |
| Brewbakers Food                     | £ 1,538,997        |              | £ 1,692,897        |              | £ 1,828,329        |             | £ 1,919,745        |             | £ 2,015,732        |                   |  |
| Brewbakers Bar                      | £ 384,749          |              | £ 423,224          |              | £ 457,082          |             | £ 479,936          |             | £ 503,933          |                   |  |
| Total Brewbakers                    | £ 1,923,747        | 42%          | £ 2,116,121        | 42%          | £ 2,285,411        | 41%         | £ 2,399,681        | 41%         | £ 2,519,666        | 39%               |  |
| Leisure                             | £ 171,807          | 4%           | £ 209,041          | 4%           | £ 219,493          | 4%          | £ 230,467          | 4%          | £ 241,991          | 4%                |  |
| Minor Operated Departments          | £ 5,645            | 0%           | £ 5,844            | 0%           | £ 6,571            | 0%          | £ 7,267            | 0%          | £ 7,836            | 0%                |  |
| Rental & Other Income               | £ 118,802          | 3%           | £ 128,656          | 3%           | £ 148,905          | 3%          | £ 164,683          | 3%          | £ 177,580          | 3%                |  |
| <b>Total</b>                        | <b>£ 4,596,051</b> | <b>100%</b>  | <b>£ 5,032,780</b> | <b>100%</b>  | <b>£ 5,638,477</b> | <b>100%</b> | <b>£ 6,095,760</b> | <b>100%</b> | <b>£ 6,498,667</b> | <b>100%</b>       |  |
| <b>COST OF SALES</b>                |                    |              |                    |              |                    |             |                    |             |                    |                   |  |
| Brewbakers Food                     | £ 461,699          | 30%          | £ 490,940          | 29%          | £ 511,932          | 28%         | £ 537,529          | 28%         | £ 564,405          | 28%               |  |
| Brewbakers Bar                      | £ 107,730          | 28%          | £ 110,038          | 26%          | £ 114,271          | 25%         | £ 119,984          | 25%         | £ 125,983          | 25%               |  |
| Total Brewbakers                    | £ 569,429          | 30%          | £ 600,978          | 28%          | £ 626,203          | 27%         | £ 657,513          | 27%         | £ 690,388          | 27%               |  |
| Leisure                             | £ 42,952           | 25%          | £ 50,170           | 24%          | £ 50,483           | 23%         | £ 53,007           | 23%         | £ 55,658           | 23%               |  |
| Minor Operated Departments          | £ 1,411            | 25%          | £ 1,403            | 24%          | £ 1,511            | 23%         | £ 1,671            | 23%         | £ 1,802            | 23%               |  |
| <b>Total</b>                        | <b>£ 44,363</b>    | <b>1%</b>    | <b>£ 51,572</b>    | <b>1%</b>    | <b>£ 51,995</b>    | <b>1%</b>   | <b>£ 54,679</b>    | <b>1%</b>   | <b>£ 57,460</b>    | <b>1%</b>         |  |
| <b>DIRECT EXPENSES</b>              |                    |              |                    |              |                    |             |                    |             |                    |                   |  |
| Rooms                               | £ 237,605          | 10%          | £ 231,581          | 9%           | £ 238,248          | 8%          | £ 263,493          | 8%          | £ 284,128          | 8%                |  |
| Total Brewbakers                    | £ 134,662          | 7%           | £ 126,967          | 6%           | £ 114,271          | 5%          | £ 119,984          | 5%          | £ 125,983          | 5%                |  |
| Leisure                             | £ 17,181           | 10%          | £ 18,814           | 9%           | £ 17,559           | 8%          | £ 18,437           | 8%          | £ 19,359           | 8%                |  |
| Minor Operated Departments          | £ 565              | 10%          | £ 526              | 9%           | £ 526              | 8%          | £ 581              | 8%          | £ 627              | 8%                |  |
| <b>Total</b>                        | <b>£ 390,012</b>   | <b>8%</b>    | <b>£ 377,888</b>   | <b>8%</b>    | <b>£ 370,603</b>   | <b>7%</b>   | <b>£ 402,496</b>   | <b>7%</b>   | <b>£ 430,097</b>   | <b>7%</b>         |  |
| <b>PAYROLL</b>                      |                    |              |                    |              |                    |             |                    |             |                    |                   |  |
| Rooms                               | £ 338,704          | 14%          | £ 355,640          | 9%           | £ 373,421          | 8%          | £ 392,093          | 8%          | £ 411,697          | 8%                |  |
| Total Brewbakers                    | £ 696,192          | 36%          | £ 731,002          | 9%           | £ 767,552          | 8%          | £ 805,929          | 8%          | £ 846,226          | 8%                |  |
| Leisure                             | £ 42,952           | 25%          | £ 45,099           | 22%          | £ 47,354           | 22%         | £ 49,722           | 22%         | £ 52,208           | 22%               |  |
| Minor Operated Departments          | £ 2,823            | 50%          | £ 2,964            | 51%          | £ 3,112            | 47%         | £ 3,268            | 47%         | £ 3,431            | 44%               |  |
| <b>Total</b>                        | <b>£ 1,080,671</b> | <b>24%</b>   | <b>£ 1,134,704</b> | <b>23%</b>   | <b>£ 1,191,440</b> | <b>21%</b>  | <b>£ 1,251,012</b> | <b>21%</b>  | <b>£ 1,313,562</b> | <b>20%</b>        |  |
| <b>DEPARTMENTAL PROFITS</b>         |                    |              |                    |              |                    |             |                    |             |                    |                   |  |
| Rooms                               | £ 1,799,740        | 76%          | £ 1,985,898        | 77%          | £ 2,366,429        | 79%         | £ 2,638,076        | 80%         | £ 2,855,770        | 80%               |  |
| Total Brewbakers                    | £ 523,463          | 27%          | £ 657,174          | 31%          | £ 777,386          | 34%         | £ 816,255          | 34%         | £ 857,068          | 34%               |  |
| Leisure                             | £ 68,723           | 40%          | £ 94,958           | 45%          | £ 104,096          | 47%         | £ 109,300          | 47%         | £ 114,765          | 47%               |  |
| Minor Operated Departments          | £ 847              | 15%          | £ 952              | 16%          | £ 1,422            | 22%         | £ 1,746            | 22%         | £ 1,976            | 25%               |  |
| Rental & Other Income               | £ 118,802          | 100%         | £ 128,656          | 100%         | £ 148,905          | 100%        | £ 164,683          | 100%        | £ 177,580          | 100%              |  |
| <b>Total</b>                        | <b>£ 2,511,575</b> | <b>55%</b>   | <b>£ 2,867,637</b> | <b>57%</b>   | <b>£ 3,398,237</b> | <b>60%</b>  | <b>£ 3,730,062</b> | <b>60%</b>  | <b>£ 4,007,159</b> | <b>62%</b>        |  |

Figure 5.21 Showing the top half of the P&L down to departmental profit

not accounted for elsewhere + any support personnel, as well as office supplies, phone line costs, etc.). Then you have Sales & Marketing (payroll is simply the manager and team salaries, while expenses will be OTA costs, website costs, advertising, PR, complimentary stays, etc.). Next is Repairs & Maintenance (payroll is obvious – it's the chief engineer and his team, as well as service contracts, paint, tools, etc.). Next is HLP (heat, light, & power), followed by any brand fees and/or base management fees (i.e. the fees an operator charges to run your business, usually as a percentage of total revenue – the incentive to drive hotel income). You can build a schedule for all of these, but I most often use a ratio method, based on experience and questions asked in the field.

Last quick note – Adjusted GOP (AGOP) is the GOP less Base Management Fee (the incentive for driving profitability) and in this case, I took 5% of AGOP. To get to NOP (EBITDA) from GOP, we must deduct insurances (for buildings, etc.), property taxes, and rents (for equipment or land) and the F,F&E reserve (i.e. the reserve fund for replacement of furniture fittings and equipment, or as described to me: all the things in a hotel that would fall out if you held it upside down).

You have your full P&L in actual year values (future values based on assumed inflation + in some cases real growth).

We can now use this for our Cash Flow, project returns and DCF analysis. We will do this now to keep the flow, despite the fact that we haven't yet discussed the different forms of investment. We will get to these straight afterwards.

To start this exercise we need to obtain a development cost from the project manager, a quantity surveyor (cost consultant), or architect. Failing that, we can take the land cost (or assumed land cost plus transaction fees – depending on the location, I use 5% for land tax + 1.75% for transaction and lawyer's fees), plus an assumed construction cost per square foot (or square metre) both of which are widely available with an online meta search. The more detailed you can obtain, the better. Here is an example of what a cost plan for a development might look like:

(we are using a modular construction technique for the new Galleria Hotel, and so bedroom cost is a high percentage of the total, as it is constructed off-site and then delivered to the site, where it must then be craned into place).

We have our projected NOP and our development cost so now we need to know how we're going to finance the development. For the purposes of our example, we will assume that we can find an investor who will put in 40% of the total development cost in equity and a bank who will then lend us 60%, which is debt. We will also assume that the loan is for 10 years (after which time it will be refinanced or the project sold), at an interest rate of 7% to reflect the construction risk and the operational risk once the hotel opens (this is the commercial loan

## P3: PROFIT (THINK LIKE AN INVESTOR) 187

Proposed Galleria Hotel (with Brewbaker's Bistro)  
5 Year Pro-Forma Profit & Loss Statement

Actual Year Values  
Inflation 5%

Exhibit 1  
100 Letting Units

|                                      | Year               | 1            | 2                  | 3            | 4                  | 5            |
|--------------------------------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|
| Rooms Available                      | 36,500             | 36,500       | 36,500             | 36,500       | 36,500             | 36,500       |
| Rooms Sold                           | 26,883             | 26,503       | 28,379             | 29,892       | 30,698             |              |
| <i>Room Occupancy</i>                | 73.7%              | 72.6%        | 77.8%              | 81.9%        | 84.1%              |              |
| Average Room Rate                    | € 88.38            | € 97.09      | € 104.94           | € 110.19     | € 115.69           |              |
| Revenue per Available Room (RevPAR)  | € 65.10            | € 70.50      | € 81.59            | € 90.24      | € 97.30            |              |
| <b>REVENUES</b>                      | <b>€</b>           | <b>%</b>     | <b>€</b>           | <b>%</b>     | <b>€</b>           | <b>%</b>     |
| Rooms                                | € 2,376,049        | 52%          | € 2,573,118        | 51%          | € 2,978,098        | 53%          |
| Brewbakers Food                      | € 1,538,997        |              | € 1,692,897        |              | € 1,826,329        |              |
| Brewbakers Bar                       | € 384,749          |              | € 423,224          |              | € 457,082          |              |
| Total Brewbakers                     | € 1,923,747        | 42%          | € 2,116,121        | 42%          | € 2,285,411        | 41%          |
| Leisure                              | € 171,807          | 4%           | € 209,041          | 4%           | € 219,493          | 4%           |
| Minor Operated Departments           | € 5,645            | 0%           | € 5,844            | 0%           | € 6,571            | 0%           |
| Rental & Other Income                | € 118,802          | 3%           | € 128,656          | 3%           | € 148,905          | 3%           |
| <i>Total</i>                         | <b>€ 4,596,051</b> | <b>100%</b>  | <b>€ 5,032,780</b> | <b>100%</b>  | <b>€ 5,638,477</b> | <b>100%</b>  |
| <b>COST OF SALES</b>                 | <b>€</b>           |              | <b>€</b>           |              | <b>€</b>           |              |
| Brewbakers Food                      | € 461,699          | 30%          | € 490,940          | 29%          | € 511,932          | 28%          |
| Brewbakers Bar                       | € 107,730          | 20%          | € 110,038          | 20%          | € 114,271          | 25%          |
| Total Brewbakers                     | € 569,429          | 30%          | € 600,978          | 28%          | € 626,203          | 27%          |
| Leisure                              | € 42,952           | 25%          | € 50,170           | 24%          | € 50,483           | 23%          |
| Minor Operated Departments           | € 1,411            | 25%          | € 1,403            | 24%          | € 1,511            | 23%          |
| <i>Total</i>                         | <b>€ 44,363</b>    | <b>1%</b>    | <b>€ 51,572</b>    | <b>1%</b>    | <b>€ 51,995</b>    | <b>1%</b>    |
| <b>DIRECT EXPENSES</b>               | <b>€</b>           |              | <b>€</b>           |              | <b>€</b>           |              |
| Rooms                                | € 237,605          | 10%          | € 231,581          | 9%           | € 238,248          | 8%           |
| Total Brewbakers                     | € 134,662          | 7%           | € 126,967          | 6%           | € 114,271          | 5%           |
| Leisure                              | € 17,180           | 10%          | € 18,814           | 9%           | € 17,559           | 8%           |
| Minor Operated Departments           | € 565              | 10%          | € 526              | 9%           | € 526              | 8%           |
| <i>Total</i>                         | <b>€ 390,012</b>   | <b>8%</b>    | <b>€ 377,888</b>   | <b>8%</b>    | <b>€ 370,603</b>   | <b>7%</b>    |
| <b>PAYROLL</b>                       | <b>€</b>           |              | <b>€</b>           |              | <b>€</b>           |              |
| Rooms                                | € 338,704          | 14%          | € 355,640          | 9%           | € 373,421          | 8%           |
| Total Brewbakers                     | € 696,192          | 36%          | € 731,002          | 9%           | € 767,552          | 8%           |
| Leisure                              | € 42,952           | 25%          | € 45,099           | 22%          | € 47,354           | 22%          |
| Minor Operated Departments           | € 2,823            | 50%          | € 2,964            | 51%          | € 3,112            | 47%          |
| <i>Total</i>                         | <b>€ 1,080,671</b> | <b>24%</b>   | <b>€ 1,134,704</b> | <b>23%</b>   | <b>€ 1,191,440</b> | <b>21%</b>   |
| <b>DEPARTMENTAL PROFITS</b>          | <b>€</b>           |              | <b>€</b>           |              | <b>€</b>           |              |
| Rooms                                | € 1,799,740        | 76%          | € 1,985,898        | 77%          | € 2,366,429        | 79%          |
| Total Brewbakers                     | € 523,463          | 27%          | € 657,174          | 31%          | € 777,386          | 34%          |
| Leisure                              | € 68,723           | 40%          | € 94,958           | 45%          | € 104,096          | 47%          |
| Minor Operated Departments           | € 847              | 15%          | € 952              | 16%          | € 1,422            | 22%          |
| Rental & Other Income                | € 118,802          | 100%         | € 128,656          | 100%         | € 148,905          | 100%         |
| <i>Total</i>                         | <b>€ 2,511,575</b> | <b>55%</b>   | <b>€ 2,867,637</b> | <b>57%</b>   | <b>€ 3,398,237</b> | <b>60%</b>   |
| <b>UNDISTRIBUTED EXPENSES</b>        | <b>€</b>           |              | <b>€</b>           |              | <b>€</b>           |              |
| <i>Admin &amp; General</i>           |                    |              |                    |              |                    |              |
| Payroll                              | € 275,763          | 6.0%         | € 301,967          | 6.0%         | € 338,309          | 6.0%         |
| Expenses                             | € 91,921           | 2.0%         | € 100,656          | 2.0%         | € 112,770          | 2.0%         |
| <i>Sales &amp; Marketing</i>         |                    |              |                    |              |                    |              |
| Payroll                              | € 68,941           | 1.5%         | € 75,492           | 1.5%         | € 84,577           | 1.5%         |
| Expenses                             | € 183,842          | 4.0%         | € 201,311          | 4.0%         | € 225,539          | 4.0%         |
| <i>Repairs &amp; Maintenance</i>     |                    |              |                    |              |                    |              |
| Payroll                              | € 45,961           | 1.0%         | € 50,328           | 1.0%         | € 56,385           | 1.0%         |
| Expenses                             | € 45,961           | 1.0%         | € 50,328           | 1.0%         | € 56,385           | 1.0%         |
| <i>HLF</i>                           |                    |              |                    |              |                    |              |
| HLF                                  | € 229,803          | 5.0%         | € 251,639          | 5.0%         | € 281,924          | 5.0%         |
| <i>Royalty (brand) Fees</i>          |                    |              |                    |              |                    |              |
| Royalty (brand) Fees                 | € 45,961           | 1.0%         | € 50,328           | 1.0%         | € 56,385           | 1.0%         |
| <i>Base Management Fee</i>           |                    |              |                    |              |                    |              |
| Base Management Fee                  | € 91,921           | 2.0%         | € 100,656          | 2.0%         | € 112,770          | 2.0%         |
| <i>Sub-Total</i>                     | <b>€ 1,080,072</b> | <b>23.5%</b> | <b>€ 1,182,703</b> | <b>23.5%</b> | <b>€ 1,325,042</b> | <b>23.5%</b> |
| <b>GROSS OPERATING PROFIT</b>        | <b>€ 1,431,503</b> | <b>31.1%</b> | <b>€ 1,684,934</b> | <b>33.5%</b> | <b>€ 2,073,195</b> | <b>36.8%</b> |
| Adjusted GOP (GOP - Base Mgmt. Fee)  | € 1,339,582        |              | € 1,584,278        |              | € 1,960,425        |              |
| <b>Less</b>                          |                    |              |                    |              |                    |              |
| Incentive Management Fee             | € 66,979           | 1.5%         | € 79,214           | 1.6%         | € 98,021           | 1.7%         |
| Insurances                           | € 45,961           | 1.0%         | € 50,328           | 1.0%         | € 56,385           | 1.0%         |
| Property Taxes                       | € 45,961           | 1.0%         | € 50,328           | 1.0%         | € 56,385           | 1.0%         |
| Rents                                | € 2,298            | 0.1%         | € 2,516            | 0.1%         | € 2,819            | 0.1%         |
| Fixtures, Fittings & Equipment       | € 45,961           | 1.0%         | € 100,656          | 2.0%         | € 169,154          | 3.0%         |
| <i>Sub-Total</i>                     | <b>€ 207,159</b>   | <b>4.5%</b>  | <b>€ 283,042</b>   | <b>5.6%</b>  | <b>€ 382,764</b>   | <b>6.8%</b>  |
| <b>NET OPERATING PROFIT (EBITDA)</b> | <b>€ 1,224,345</b> | <b>26.6%</b> | <b>€ 1,401,892</b> | <b>27.9%</b> | <b>€ 1,690,431</b> | <b>30.0%</b> |
|                                      |                    |              |                    |              |                    |              |
|                                      |                    |              |                    |              |                    |              |

Figure 5.22 Illustrating the complete P&L down to NOP/EBITDA

**Development Cost**

|                   |          |                  |            |
|-------------------|----------|------------------|------------|
| Land Cost         | €        | 2,000,000        |            |
| Acquisition Costs | €        | 135,000          | 7%         |
| <b>Land Costs</b> | <b>€</b> | <b>2,135,000</b> | <b>18%</b> |

**Construction Costs**

|                               |          |                   |             |
|-------------------------------|----------|-------------------|-------------|
| Bedroom Cost                  | €        | 5,990,148         | 60%         |
| Substructure                  | €        | 394,089           | 4%          |
| Frame                         | €        | 394,089           | 4%          |
| Common Areas                  | €        | 98,522            | 1%          |
| Roof                          | €        | 49,261            | 0%          |
| Stairs                        | €        | 98,522            | 1%          |
| External Walls/Windows/Doors  | €        | 197,044           | 2%          |
| Internal Walls/Partitions     | €        | 88,670            | 1%          |
| Internal Doors                | €        | 39,409            | 0%          |
| Finishes                      | €        | 49,261            | 0%          |
| M&E                           | €        | 1,400,000         | 14%         |
| F,F&E                         | €        | 1,200,000         | 12%         |
| Prelims OH&P                  | €        | 500,000           | 5%          |
| Contingency                   | €        | 500,000           | 5%          |
| Professional Fees             | €        | 900,000           | 9%          |
|                               | €        | 10,000,000        | 82%         |
| <b>Total Development Cost</b> | <b>€</b> | <b>12,135,000</b> | <b>100%</b> |

*excluding finance during construction*

**Figure 5.23** Illustrating the development cost schedule including construction costs, contingency professional fees

rate and reflects the base rate + a risk premium for a loan of only 60% of the total investment). While equity will typically wish to see a return of >10%, commercial debt may only have a risk premium of base rate + 1–3%, because in the bank's calculations, the equity investor will lose their money before the bank's loan is at risk of default, which they effectively count as a contingency against the project failing.

If it all goes wrong, the bank (who typically holds the title deeds) can foreclose on the loan and force the sale of the asset, to recover their money from the sale.

In this case, they would have to sell the hotel at >40% less than the cost of development before their money is at risk, which is a comfortable buffer, hence an interest rate is only base rate + 2%, i.e. 7% in our example. As a side note, banks will normally look for a debt service ratio of >1.8 to make sure the cash flowing from the business is sufficient to cover the debt service in any one year (this project gets close to 1.0 debt service cover i.e. there is no buffer in year 2 – we might get away with this because of the cumulative cash flow from the previous year; however, that too relied on a moratorium on loan repayments for the first year i.e. no repayments of the loan principal, only the interest in that year, so it might be touch and go with the bank).

Because our cash flow will run for 10 years, we must therefore extrapolate our projections for 10 years (we do this by taking the stabilised year of our forecast (year 3), where there is no more real growth, and then apply inflationary growth for years 4–10.

In our example, we have taken the NOP/EBITDA and deducted the cost of debt service, to give an annual cash surplus or loss upon which to base our Return on Equity calculations (this is just an IRR calculation on the cash surplus figure with the equity invested put into year 0 as a negative). We have done the same with the total development cost and the NOP cash flow to calculate the IRR on capital figure.

In both cases, we have applied a 10% exit yield (x10 multiple) to the 10<sup>th</sup> year's cash flow to give a capital value (assuming a notional sale in year 10) to add to the cash flow in year 10. We also ran a debt service schedule based on the loan parameters shown.

## Capital & Investment

We have already started to look at the nature of capital in different guises from the outset of this chapter. To clarify, Capital tends to mean longer-term investments for more finance intense purposes (like hospitality and real estate development). The other thing to mention here is that there is a fundamental difference between Operational Expenditure (OPEX) and Capital Expenditure (CAPEX). CAPEX is for long-term reasons, while OPEX is for shorter term or day-to-day investment. CAPEX tends to be money raised or saved specifically for the chosen investment, while OPEX tends to come from the cash flow of the business. The simplest example that shows the distinction might be F,F&E reserve and the maintenance budget. The F,F&E reserve is money accrued over years to be spent proactively on large-scale, planned refurbishment projects and so on. The maintenance budget comes out of OPEX (trading cash flow) to pay for planned daily maintenance (facilities management) and reactive, urgent repairs and repainting walls, etc. damaged by suitcases and stag parties.

| Proposed New Galleria Hotel Statement of Pre-Tax Cash Flow |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
|--|--------------|-------------|-------------------------|-------------|-------------|-------------|----------------------------|-------------|-------------------------|-------------|--|--|--|--|--|--|--|--|--|--|--|--|
| Inflation Rate 5%  |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Actual Year Values   |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Year   | 1            | 2           | 3                       | 4           | 5           | 6           | 7                          | 8           | 9                       | 10          |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>Gross Operating Profit</b>                              | € 1,431,503  | € 1,684,934 | € 2,073,195             | € 2,297,558 | € 2,479,972 | € 2,603,971 | € 2,734,170                | € 2,870,878 | € 3,014,422             | € 3,165,143 |  |  |  |  |  |  |  |  |  |  |  |  |
| <i>less</i>  |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Incentive Management Fee                                   | € 66,979     | € 79,214    | € 98,021                | € 108,782   | € 117,500   | € 123,375   | € 129,544                  | € 136,021   | € 142,822               | € 149,963   |  |  |  |  |  |  |  |  |  |  |  |  |
| Insurances   | € 45,961     | € 50,328    | € 56,385                | € 60,958    | € 64,987    | € 68,236    | € 71,648                   | € 75,230    | € 78,992                | € 82,941    |  |  |  |  |  |  |  |  |  |  |  |  |
| Property Taxes   | € 45,961     | € 50,328    | € 56,385                | € 60,958    | € 64,987    | € 68,236    | € 71,648                   | € 75,230    | € 78,992                | € 82,941    |  |  |  |  |  |  |  |  |  |  |  |  |
| Rents  | € 2,298      | € 2,516     | € 2,819                 | € 3,048     | € 3,249     | € 3,412     | € 3,582                    | € 3,762     | € 3,950                 | € 4,147     |  |  |  |  |  |  |  |  |  |  |  |  |
| Fixtures, Fittings & Equipment                             | € 45,961     | € 100,656   | € 169,154               | € 182,873   | € 194,960   | € 204,708   | € 214,943                  | € 225,691   | € 236,975               | € 248,824   |  |  |  |  |  |  |  |  |  |  |  |  |
| Sub-Total  | € 207,159    | € 283,042   | € 382,764               | € 416,618   | € 445,683   | € 467,967   | € 491,365                  | € 515,933   | € 541,730               | € 568,817   |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>Annual Surplus Before Debt</b>                          | € 1,224,345  | € 1,401,892 | € 1,690,431             | € 1,880,940 | € 2,034,290 | € 2,136,004 | € 2,242,805                | € 2,354,945 | € 2,472,692             | € 2,596,327 |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>Service and Before Taxation</b>                         |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>Debt Service:</b>                                       |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest   | 539,401      | 539,401     | 479,467                 | 419,534     | 359,601     | 299,667     | 239,734                    | 179,800     | 119,867                 | 59,933      |  |  |  |  |  |  |  |  |  |  |  |  |
| Loan Repayment   | -            | 856,192     | 856,192                 | 856,192     | 856,192     | 856,192     | 856,192                    | 856,192     | 856,192                 | 856,192     |  |  |  |  |  |  |  |  |  |  |  |  |
|  | 539,401      | 1,395,593   | 1,335,659               | 1,275,726   | 1,215,793   | 1,155,859   | 1,095,926                  | 1,035,992   | 976,059                 | 916,125     |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>ANNUAL SURPLUS/(DEFICIT)</b>                            | € 684,944    | € 6,300     | € 354,772               | € 605,214   | € 818,497   | € 980,146   | € 1,146,879                | € 1,318,953 | € 1,496,633             | € 1,680,202 |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>BEFORE TAXATION</b>                                     |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>CUMULATIVE SURPLUS</b>                                  | € 684,944    | € 691,244   | € 1,046,016             | € 1,651,230 | € 2,469,727 | € 3,449,873 | € 4,596,751                | € 5,915,705 | € 7,412,338             | € 9,092,540 |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>BEFORE TAXATION</b>                                     |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest Coverage  | 2.3          | 2.6         | 3.5                     | 4.5         | 5.7         | 7.1         | 9.4                        | 13.1        | 20.6                    | 43.3        |  |  |  |  |  |  |  |  |  |  |  |  |
| Debt Service Coverage                                      | 2.3          | 1.0         | 1.3                     | 1.5         | 1.7         | 1.8         | 2.0                        | 2.3         | 2.5                     | 2.8         |  |  |  |  |  |  |  |  |  |  |  |  |
| Annual Equity Return                                       | 14%          | 0%          | 7%                      | 12%         | 17%         | 20%         | 24%                        | 27%         | 31%                     | 35%         |  |  |  |  |  |  |  |  |  |  |  |  |
| <b>LOAN TERMS</b>  |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Total Development Cost                                     | \$12,135,000 |             | Development Cost / Room |             | \$121,350   |             | excl. capitalised interest |             | US\$000s                |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Loan % of TDC  | 60.0%        |             |                         |             |             |             |                            |             | Debt 7,281,000 60.0%    |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Loan Interest  | 7.0%         |             |                         |             |             |             |                            |             | Equity 4,854,000 40.0%  |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Term   | 10           |             |                         |             |             |             |                            |             | Total 12,135,000 100.0% |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Moratorium   | 1            |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Interest during Construction                               | 0.5          |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| Capitalised Interest                                       | \$424,725    |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| years from opening   |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| year from opening  |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |
| years  |              |             |                         |             |             |             |                            |             |                         |             |  |  |  |  |  |  |  |  |  |  |  |  |

Figure 5.24 Showing the cash flow derived from NOP before and after debt service

| Yield/Disc Factor<br>10% |   |             |              |
|--------------------------|---|-------------|--------------|
| Exit Value (Yr10)        |   |             |              |
| Year                     | € | 16,802,019  | € 25,963,266 |
| 0                        |   | -4,854,000  | -12,559,725  |
| 1                        | € | 684,944     | € 1,224,345  |
| 2                        | € | 6,300       | € 1,401,892  |
| 3                        | € | 354,772     | € 1,690,431  |
| 4                        | € | 605,214     | € 1,880,940  |
| 5                        | € | 818,497     | € 2,034,290  |
| 6                        | € | 980,146     | € 2,136,004  |
| 7                        | € | 1,146,879   | € 2,242,805  |
| 8                        | € | 1,318,953   | € 2,354,945  |
| 9                        | € | 1,496,633   | € 2,472,692  |
| 10                       | € | 18,482,221  | € 28,559,593 |
| Return on Equity         |   | 22%         | 19%          |
|                          |   | £25,894,559 | £21,604,370  |

**Figure 5.25** Showing the DCF calculations to arrive at ROE and IRR for the project

Capital can either be an investment in a business or project by investors, or investment by management into the business. We've established that every investment involves a risk today that requires a return over time (usually measured financially), whether that's your pension contributions or buying a timeshare. Generally, money loves to get as high a return for as little risk as possible. As with our Galleria Hotel example, there are asset-backed loans (like a mortgage), where the lender or bank lends against the security of an asset (usually the title deeds of the freehold), so that if there is a default, they can sell the asset to get their money back.

There is a pecking order in what is known as the capital stack (the amalgamation of capital assigned to a project of different types and usually from different sources), with priority going to senior debt providers (secured creditors), then on down to the equity investors. For reference, if a project goes sideways and the bank calls in its loan(s), the company (or holding vehicle) will most likely be put into administration first (similar to Chapter 11 in the US) and then into insolvency (bankruptcy) if the financial difficulties cannot be resolved. If the firm goes into bankruptcy, the secured creditors get their money out first, then the preferred creditors, typically employees who are owed wages or creditors with a floating charge (a charge over current assets that can be converted into cash

within one year – e.g. bank overdraft) etc., and then the unsecured creditors (equity investors etc.). In the UK you will be relieved to know that the body that has first dibs on any money is the tax man (who hasn't made any direct investment into the business at all, but may still be owed back taxes).

### The Capital Stack

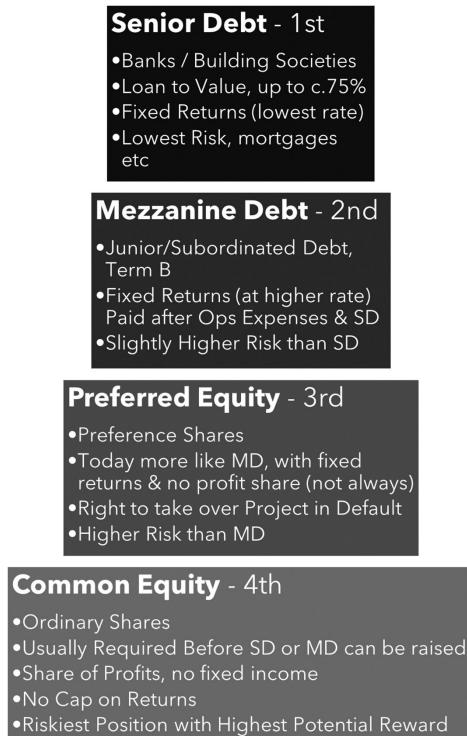
While we're here, let's look at a quick summary of capital (see Figure 5.26).

As the table indicates, most debt finance will require that the project sponsor(s) put equity into the project, to give the buffer we spoke about before, as well as a device to ensure the sponsor feels more pain than the lender (to try and maintain their project focus and determination to succeed) – this is called *Skin in the Game*. I guess there are projects out there where the sponsors would borrow money and not care too much if their project fails, but in my experience, these people are devoted, and the vulnerability of their position on Maslow's hierarchy is enough to provide sufficient motivation to not need SitG, but that's just me. Then there are what are known as Single-Tier Equity Structures, where there is a senior loan, and two-types of shares, A & B. The A shares are issued to investors who are making the bulk of the investment between them (sometimes called the Limited Partners) and take little or no responsibility for the operation of the business (or delivery of the project). The B shares are issued to the sponsors (sometimes called General Partners), who thought up the idea, put the deal together and run the operation (and only put in SitG, if anything at all). When it comes to a sale of the underlying asset or business, the senior debt is paid back and then profits are split between shareholders on the basis of 70% to A shares and 30% to B shares. A two-tier structure adds preferred equity to common A and B shares (usually in some form of fixed pay-out), alongside common equity A and B shares. A and B shareholders invest the majority of the money in agreed percentages (depending on how much each puts in) and then the sponsors are issued with a new band of common equity shares. Additionally, you may hear terms such as stretch debt, which is generally used in higher LTV situations (especially in property development and leveraged buyouts).

Funding falls broadly into two categories:

#### Traditional Finance:

- 1 **regulated finance:** banks and traditional lenders, etc. (through lending against deposits),
- 2 **capital market:** long-term credit (+1 year), through traded debt (like bonds) and equities, for retail customers, insurers, etc. (would include a company bond issue, an IPO (initial public offering) or floating on the stock exchange),



**Figure 5.26** Schedule of investment in the capital stack in order of seniority

3 **money markets**: short-term credit (<1 year), through treasury bills etc. (open to banks, companies, governments and NBFC/non-bank finance companies).

#### Alternative Finance:

- 1 **angels**: see venture capital below,
- 2 **bootstrapping**: an entrepreneur's own capital,
- 3 **competitions**: rare and hard to win,
- 4 **crowdfunding**: reward-based or equity,
- 5 **crypto**: usually a version of private lending,
- 6 **factoring**: or invoice finance (when a business sells the income stream it is owed that has not yet been paid, to a third party),
- 7 **friends/family**: as with bootstrapping, it tends to be smaller early-stage amounts,

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- 8 **grants:** from government or NGOs, etc. (generally no repayments, but scarce and most providers prefer to provide match-funding),
- 9 **leasing:** this can be a good way to finance expensive, slow-growth, asset-backed projects (someone else owns the asset, pays for any capital expenditure, and then charges rent to the entrepreneurial tenant), can align with risk,
- 10 **peer-to-peer:** consumer and business (e.g. a company lends to another company),
- 11 **private equity:** private investors into private companies,
- 12 **revenue-based:** for a % share of revenue (often card payment machine providers),
- 13 **social impact bonds:** specialist for special situations such as community projects,
- 14 **venture capital:** private investors into start-ups.

This list is by no means exhaustive and there are new ways of financing things appearing all the time. If you are raising funds, it is possible that you will come across Seed Funding, Venture Capital (VC), Start-up Capital that aims to achieve very high returns from investment in early stage companies (sometimes pre-revenue). Private Equity (PE), usually through tax efficient *fund* vehicles, tends to invest in slightly more mature businesses or projects that are slightly less risky with the intention of streamlining operations and driving growth. VC tends to be provided with funds from angel investors (High Net Worth Individuals, or Ultra-HNWIs) and on occasion, larger firms as part of their diversified portfolio strategy. PE may also be funded by HNWIs and larger firms. Both tend to invest in private companies, although PE will also look at public companies they can take private.

### ***Project and Business Ownership***

As you may have gathered, there are several different vehicles that are used to carry out developments, run projects and operate businesses, and it is important that we choose the most appropriate type for our needs as they each have advantages and disadvantages. The following are all types of company:

**Sole Proprietorship/Trader** – you own the business and the file requirements are relatively straightforward (you keep all the profits and file your personal taxes to include this income). Set-up costs are low and you are unlikely to benefit from commercial financing options. There is unlimited liability if you make a mistake and get sued by customers or employees. It is the extension of the individual.

**Partnership** – like a sole proprietorship, except there are two or more of you sharing the profits or losses and liabilities (which remain unlimited in this

form). As with sole traders it is a tax pass through i.e. taxes are filed and paid by the partners, not the company.

**Private Limited Companies (Ltd)** – Private company limited by shares means liability is capped to the amount invested in share capital by the shareholders (you can't lose more than you put in, unless you do something criminal). A private limited company is a separate legal entity in the eyes of the law that is owned by shareholder. Sometimes a private company might be limited by guarantee (mostly for membership organisations where the members guarantee a certain amount of the liabilities) rather than by shares. The officers of the company (not necessarily shareholders) file the company accounts separate to their own personal accounts, and make sure the company is compliant with the law. There are also CIC limited companies or equivalents, where profits are for the benefit of the community (rather than shareholders). Liability is also capped. CICs do not benefit from the tax breaks of a charity. Charities are highly complex and we will not go into them.

**Corporations** – 'C' Corporations in the USA are similar to UK Private Limited Companies in that they are owned by their shareholders, are separate legal entities and pay corporation tax. 'C' corps have no restrictions on their shareholders (which can be companies or foreign individuals). 'S' Corporations are more like LLPs and are tax transparent i.e. taxes pass through the company and are paid by individual shareholders (limited to 100 shareholders, who must be individual US citizens and not companies).

**Limited Liability Partnerships (LLP)** – are like limited companies in that the liabilities for partners are capped. The limited Liability Partnership in most cases remains a tax pass through or is tax transparent (individuals are responsible for their own affairs, while the LLP must report annual profits to Companies House, the partners are not required to divulge the distribution of those profits between partners).

**Limited Liability Companies (LLC)** – is mostly the same as an LLP but in the USA and elsewhere with similar legal systems. It is a separate legal entity, owned by its members and is also tax transparent.

**General Partnerships** – where all partners are responsible for the operation of the partnership and its activities and where liability is unlimited. These are often used by funds to invest and manage the fund's money on behalf of the limited partners and give them reassurance that because they are unlimited the general partners will execute this diligently.

**Limited Partnerships** – essentially for silent partners to invest in a fund managed by the general partner. The liabilities are limited to the sums invested which allows investors to be passive.

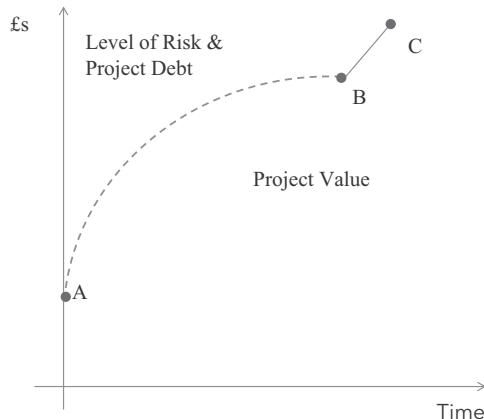
**Joint Venture Partnerships** – is a temporary partnership between parties for the purposes of completing a specific project (no special restriction of liability exists).

**Public Private Partnerships** – a government/private sector partnership that allows government to attract private sector investment and keep it off the government's balance sheet. Often used for heavy capital expenditure projects like public hospitals, where the private partner invests the money and develops the project, in return for rent payable by the tenant (health trust) for a period of time (say 20 years).

When you combine what we have learned about companies and investment, you eventually get to the tricky subject of dilution. Imagine you set up a company with your friend and give yourselves 10x \$1 shares each, call it your series A raise. The company capital is \$20. Let's say that at this stage the company is making \$100 per year, let's say we value the company at 2x profit = \$200 or  $\$200 \div 20 \text{ shares} = \$10 \text{ per share}$ . So you decide you will seek \$800 in external investment so you can invest and grow annual profit, in return for 80 x \$10 shares, call it the series B raise. You're giving up equity rather than taking a loan. The advantage is that you raise capital without burdening the company with debt obligations; the problem is that you're diluting your shares. Before, you and your friend had 50% control of the company each. Now you both have a 10% ( $\$10 \times 10 \text{ shares}$ ) of the company each, while your new investor now owns 80% ( $\$10 \times 80 \text{ shares}$ ). This means you've lost control as most companies vote on a simple majority basis. What is more, your investment pays off and now the company is making \$500 per year. Now this time (two years of trading on), you're going to value the company at 3x earnings of \$500 = \$1,500 with its existing capital held in 100 shares at \$15 per share. Picture your series C raise of say \$1,500 for another 100 shares. Now you've got 100 shares or 5% of the company. Until earnings hit your next growth target (and stay at \$500 per year), you're now going to earn 5% of \$500 = \$25. In other words, you have to grow the profit exponentially if you're ever to get ahead of your original returns.

### **The Umbrella Plan (thinking of how it ends before it begins)**

Risk changes through the life of a project and you need to decide how to balance the cost of finance (and the level of risk at any one time), against the financing options available to you. Consider that during the construction phase of a hotel development you have to put 20% of the total development cost into the project as equity and the rest will come from debt that you will draw down as needed as the project progresses. Maybe that debt comes at a price of 10% per annum because it is risky and if the project got into difficulties (a design problem, soil issue, etc.), an open market valuation of a half-finished hotel would be below what had been spent on it (say between A and B on the graph). Fortunately, you have no such problems and the hotel gets developed on time and on budget (at B) and it is worth the same as the debt spent on it. Then between B and C it starts to trade well and its value exceeds the cost. There is still some operational risk, but now



**Figure 5.27** Shows the increasing level of risk and value in the project over time

there is an underlying asset, so 10% seems expensive for your debt. Maybe that should be 6%? I would suggest you would want to cut your cloth to fit your needs at each stage. The question is, can you get your funders to play ball.

If you can't secure debt at a sensible rate for the project duration (well into trading and beyond), and you can't break down your funding into chunks that reflect the relative risks, you can only attempt to reduce the risk. That means getting your development costs as secure as possible (which may mean getting someone to deliver the build at a guaranteed price), and securing contracts with room buyers in advance of opening (so the bank can see the chances of their money coming back improve). Think widely and laterally as to how you can reduce the risks – it may mean you have to be less revolutionary in your design or ambitious in terms of scale (but don't over compensate and reduce your project to a cookie cutter offering with no USPs). Remember, RIC-RI... *Risk is Cost, Reduce it!*

| Investment Strategy                               |  |   |
|---|--|---|
| Development                                       | Buy-out / Buy-in   | Start-Up  |
| <b>Short-term Real Estate Strategy?</b>           | Acquire/Buy-in<br>Find a target with potential, do a good deal, develop the brand, grow the business & streamline operational processes? | Venture Project<br>Alternative finance, high risk, high pressure, possible high returns & no real estate (space is rented)? |
| <b>Buy land, develop it out &amp; flip it on?</b> |  |   |
| <b>Long-term Real Estate Strategy?</b>            |  |   |
| <b>Buy, Develop, Hold &amp; Grow?</b>             |  |   |

**Figure 5.28** Illustrating different types of investment depending on stage and strategy of investment

Another thing you have to do at this early stage, is think like an investor – if you were a dispassionate billionaire with multiple options of where to invest your money (and the opportunity cost of your time), would you choose to put it into your project? Or would you put it somewhere safer, how much can you afford this to fail? (back to the questions of self-discovery). Combined with this you need to be really clear on what your play is:

Consider, *How are you going to get out in an emergency if it all goes bad?* How can you protect your downside if the wheels come off? Some of this will be down to contract terms with your funders, and it is important not to get bounced into a deal because they're the only show in town. There is adverse selection in finance – a new project gets hawked around the market and the banks all say *oh no, too risky*. So the sponsors end up knocking at the door of the venture capitalists. Now the sponsor's project is capital intensive, so will need an investor with deep pockets over a long period of time. The venture capitalists charge a lot for their investment and so only attract investment opportunities that cannot get funding elsewhere, and these risky projects cannot support the VC returns, so are bound to fail. Optimistic entrepreneurs and VCs alike, suffer from asymmetry of information and may set up self-fulfilling prophecies where no one wins. Just because you are notionally co-investors with the PE firm (although really you're probably the junior partner), don't think you want the same things. You are the entrepreneur and may have tremendous enthusiasm, focus and belief in your project; the PE team is paid to be dispassionate about making money from investments (and taking their cut on the way through). They're only interested in your purpose and passion if it's going to help you hit and exceed the hurdle rate (Minimum Acceptable Rate of Return) and not fail and lose them money.

How are you going to create a safe investment, where you achieve your goals and the money achieves theirs?

It can also work the other way around. In the years leading up to the pandemic, a number of start-up hotel, hostel and co-working companies sprang up. As we all have, these guys struggled to find funding for their expansion from traditional sources – too much risk for the size, duration and returns on investment. So these guys went elsewhere, including Silicon Valley and the like, where investors were more used to putting money into early-stage, high-risk investments, whose only assets were intangible (intellectual property and software mostly) and definitely not chunky, cash-hungry real estate. The other advantage of these types of investor was that they didn't expect to get cash flow positive for a long time, possibly years. The problems started when the borrowers didn't invest all or much of their funding in their scalable, efficiency promoting tech and instead invested large sums into buying real estate. The problems started appearing when the capital ran out and yet there was still no sign of any returns – buildings and land were bought, but development and subsequent ramping up of the sitting businesses took a long time. Tech investors had become real estate investors and they

weren't happy about it. In most cases, the wheels eventually came off with the pandemic, which like the GDC, revealed who'd been *swimming naked* – analysts panicked, executive teams were fired, corporate jets were confiscated and investors lost their shirts. Sad, but entirely predictable.

Even, if there isn't asymmetry of information, systematic risk can get you – don't forget, the hospitality industry is a mirror of the wider economy and therefore can be very cyclical. This can sometimes make the cost of borrowing critical. The sector is also very vulnerable to shocks and a hotel room or a restaurant seat are highly perishable – don't sell bedroom 4 on Friday 23<sup>rd</sup> and the revenue opportunity is gone forever.

So, be sure you know what happens to the sale of the asset and any surplus funds (where do you stand in the queue to get your money back?). Whatever happens, make sure you get as good a set of terms as you can that are realistically sustainable in the long run, and then build solid foundations in your relationship with your funder with open lines of communication. Keep them updated at all times and give them as much notice of potential problems before they arrive. While you, your investor and staff might all have different agendas, it is important that you function as a team. Every book like this has to have its own special formula, so I give you my formula for success:

$$(Returns)^n = \frac{(Investment + Customers)Strategy^{Team}}{Time - Innovation}$$

The intuition of which is: multiple Returns are the result of project Investment + the goodwill of your customers, multiplied by your strategy, raised by the power of your team, all of which is divided by the discounting and limiting force of time, minus the offset of innovative ideas and technology that effectively buy you time and reduce their effects.

The other thing to consider is, *How are you going to get out at the end?* Your exit will depend largely on what you do and how you do it at the beginning – financial structure is one part, but also think, is the business going to be sellable? Think about a chef-patron who starts her own restaurant. Things go well and after 20 years, she decides to retire, or do something else. It is only when it comes to selling that she realises the business is worth nothing without her and no investor want to pay top whack for a restaurant when the chef whose name above the door drives all of the trade. Equally, maybe she doesn't want to sell up entirely, but would like to release some equity to put into another project by selling the freehold, but the new owner wants a shoe shop not a restaurant. Maybe it's on a lease and she discovers there is no right to transfer the lease to another tenant. All things to consider early on. What you do today and the way you do it can significantly impact your tomorrow.

# Chapter 6

## PROJECT CONCEPT

### Defining Your Project

#### Design

Now that you've done the mental acrobatics of dreaming up a concept, using whichever method worked for you, and maybe had a go at developing a brand identity and even building a P&L, it's time to define your concept...which really means evolving it, polishing it and looking at it in detail, separate from the business plan (which is where a version of it is heading soon). To do this, we need to remember our DADA loop from the strategy section. At this stage, your concept definition is your hypothesis that we'll learn to test in the next chapter. The testing and updating of your hypothesis is an ongoing process that extends throughout the lifespan of your project. We can start by imagining our guest of the future and rationalising backwards to see how and what we are going to deliver for them to fulfil and achieve our respective goals and ambitions.

We will see how constant improvement and refining processes extend into project management later in the book, when your professional teams (architects, engineers and cost consultants) have their input into your concept design. Just keep in mind that if everyone adds their bit of colour to a plan without some direction, the outcome of the blend is brown, or best grey. It is where the allegory of the camel being a horse designed by committee comes from (a hump to make it go further, bigger feet so it doesn't sink, etc.). To avoid this type of watering

down or the deflection of your purpose, I suggest developing a definite opinion and writing it down to avoid confirmation bias (the tendency to agree with the opinion of your peers) and reinforce the courage to say no or stick to your guns.

Additionally, we need to understand our GBB: is our offering Good, Better or Best? Or to put it in Michael Porter's language:

**Cost Leadership** (McDonald's, Ikea, Ryanair) = being the lowest cost operator in the industry, work at economies of scale (being bigger, faster, selling more) and limiting the features of your product to enable you to do it.

**Cost Focus** (campsites, local or 'greasy-spoon' restaurants) = still being a low-cost provider, but targeting a specific market segment (can't use economies of scale so easily, so lower overheads and material costs, offer a more basic product).

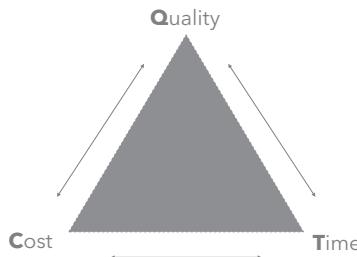
**Differentiation** (Four Seasons, Belmond, Louis Vuitton) = unique, distinct products (emphasis on added benefits and quality of production).

**Differentiation Focus** (Shake Shack, Five Guys, Gordon Ramsay Burger) = as with broad market differentiation, premium perception (quality produce and production), in a niche market.

There are implications to our choice, of where we choose to sit in the market, on both sides of the coin – customer value perceptions and production/distribution costs. It might be helpful to think of the production side in terms of the CQT triangle:



**Figure 6.1** Representation of the Product Differentiation Matrix



**Figure 6.2** The CQT Triangle

Unless you can harness a new and innovative technology or process, if you increase the quality of what you make or do, it will take longer and cost more to produce. If you want to make something faster, the quality is likely to suffer and it will be more expensive to produce (maybe you have to throw more resources at the problem). If you want to make something cheaper, you will struggle to offer as high a quality product and it could take longer (maybe your priority in the queue reduces and your suppliers get to you when they can, after they've looked after their clients who are paying more for faster or higher quality delivery).

There is also a customer psychology piece to your good, better, best decisions too. According to Rory Sutherland (in *Alchemy: The Surprising Power of Ideas That Don't Make Sense*), there are two sorts of consumer in the world, the satisfiers and the maximisers (or optimisers). To be clear, we can all be either at any time and can change between them at will. ‘*Satisficing*’ is the combination of satisfying and sufficing (originally coined by Herbert Simon, c.1950) and means, *I haven't got the time or inclination to research my choices, so I will buy what appears to do the job and costs as little as is reasonable* (probably mostly informed by what we see others buying – beware the review that appears first or most easily). The optimisers on the other hand, spend time and effort understanding the process, what makes a great example of the product, what the price points and trade-offs are, what the options are, and who uses which. They become subject matter experts on whatever falls under their choice microscope (and could probably go on BBC's *Mastermind* and have it as their specialist subject). Optimisers are still influenced by endorsements (expert rather than celebrity) and reviews, but will also want to be able to easily access additional information regarding the attributes and benefits.

Let's get cracking, revisit another bit of social psychology, in this case duration neglect and the peak end rule. These two combine to create a cognitive bias (like the others we have studied), where in essence, people forget about how long an experience lasts and instead recall the most significant moments during the experience. This theory was largely developed by Daniel Kahneman and Barbara Fredrickson, who tested subjects in a number of scenarios and discovered that

during a painful or unpleasant event, people remembered the degree of pain at its worst and what happened at the end of the event. They had no particular recollection of how long the event lasted overall. The opposite is true too, as we tend to remember the positive peaks and endings more readily. This is in part because we tend to recall memories as snapshots, rather than as movies. This is significant to the hospitality professional for two reasons:

- i) We need to create highlights and special moments during a guest visit with us. We cannot and shouldn't try to maintain 100% engagement throughout – it's not cost effective, or realistic and it doesn't allow our guests to generate those memorable snapshots;
- ii) We need to make sure we send our departing guests away on a high, ideally with something to talk about and share. This concept ties in nicely with our exploration of complaint handling.

To give you some context to this, the Magic Castle Hotel in Los Angeles achieves some of the highest guest review scores in the whole city, despite being a fairly expensive, mid-grade, aging property that has some big hitting competition on the doorstep. One of the reasons they achieve such a loyal following, is that they have the 'Popsicle Hotline'. If you are lying by the pool, you can pick up the big red phone (like the ones in the movies circa 1970s) and it automatically connects you with an attendant who will take your complimentary popsicle order – that arrives moments later on a silver tray. This is a quirky, memorable feature and the guests show their love and appreciation of it by leaving great reviews and returning time and time again. Similarly, when Disney designs a ride, they do not attempt to keep your adrenaline flooding your system throughout the ride, it has spikes and flatlines – people remember the peaks. Disney is also clever at managing your expectation to ensure you leave with positive memories, down to the smallest details, like queuing. At Disney parks, queues for popular rides in the holidays, can often extend to over an hour's wait - a long time if you have hot, bothered, restless children. To moderate the pain, they provide queueuers with an estimated queue time until their allotted slot. It turns out that this estimation, frequently exceeds the actual time it takes until your turn comes around – with the result that you don't recall how long you were actually waiting, all you remember is that it didn't take as long as you thought it would. If you've never been to Disney World, you can see this for yourself when you're waiting for the train – if the dot matrix display tells you the train will be there in 2 minutes, you'll wait there happily until it arrives. If the display is broken, a two minute wait can seem like an eternal wait in purgatory – to the point you might even consider alternative forms of transport. There are many other examples: chocolates on the pillow, candy with the bill, etc. The point is clear, provide magic moments and make sure guests leave on a high.

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You may know of the story of the hotel guest whose son left his favourite bedtime soft toy behind following their stay. The little boy was unable to sleep without it, so the father spun a yarn about how the toy was still on holiday and would catch them up in a few days. He then called the hotel and asked if anything had been handed in. The hotel searched and found the treasured item, promising to return it. In the meantime and in an inspired moment, members of the hotel team took and photos of the toy enjoying the various facilities and activities at the property (lounging by the pool, enjoying the spa) and sent them to the boy's father. You can well imagine the sheer delight of the child and the impact that had on the family's loyalty towards the brand.

To wrap this up before I give you a worked example, I would like to share a moment about how to create methodology, as developed by the psychologists Dan and Chip Heath (and relayed in their book, *The Power of Moments: Why Certain Experiences Have Extraordinary Impact*). Their insights are brilliant and provide support for the Magic Castle's strategy – I recommend taking the time to study their text in full. Their EPIC acronym is a helpful aide memoir, and if you can achieve just one element in your offer you'll be heading in the right direction:

**Elevate** – lift your experience above the ordinary, make it exceptional enough to make it exciting and memorable;

**Pride** – instil a sense of achievement or special occasion;

**Insight** – help your guests gain knowledge or insights by asking the right questions (literally or through the environment) to guide their thinking (remember how the generation effect makes memories stickier);

**Connection** – give your guests the opportunity to feel a sense of belonging, be part of something and build meaningful connections).

The more of these points you can hit, the better. One of their examples to really breathe life into their theory is the story of the medical engineer, whose team developed a new and very efficient MRI scanner. Proud of their design, he went to see it in action in a live situation. At the time a young boy was about to be scanned. The machine's design had fulfilled the brief, but as usual was very noisy, unfriendly and cramped for patients. The child was terrified and struggled to overcome his claustrophobia, initially refusing to get into the machine. This is not uncommon and children often require sedation before scanning. The engineer was so dismayed that he went home and called his team together to redesign the appearance of the machine. From then on, they produced, a range of bespoke designs to distract users from the real purpose of the machine, from cable cars (with pictures of the surrounding mountain and pretend tickets for *travellers*) to

submarines and beyond. Imagine what you can do to your design to make your guests feel safe, special, inspired and connected.

It is important to employ a capable architect when imagining your future hospitality *space*. For example, you may use clever lighting to create darker corners where people can sit in obscurity to observe. Equally, lighting and the intelligent use of fabrics may also be used to convey luxury – appealing to people's social status. Going back to 1990s London, British designer, restaurateur, retailer and writer Sir Terence Conran, opened Quaglino's restaurant in St James's. The main dining area was situated downstairs, in a semi-basement, so Conran made a design feature of a large sweeping staircase with uplighters in each of the risers that brought guests down into the restaurant from the bar. Whether imagined or otherwise, as you descended the stairs you felt like everyone of your fellow diners was looking at you – you felt you were making an entrance, you felt like a movie star. Far from the basement setting being a drawback, it became a point of difference that made every guest feel special...and got them coming back time and time again.

The next point I'd like to make on this subject regards friction. We have seen how increasing friction in packaging or process can convey quality of the offering. Now I'd like you to consider how decreasing friction can instigate action. In Soho, London there's a restaurant called Bob Ricard, where they have installed a '*press for champagne*' button on each table. The result is that they sell more champagne than almost anywhere else in England. Supermarkets use similar techniques, with narrow aisles, stacked high with mundane low-profit items (breakfast cereals etc.) to squeeze you quickly through them, while veritable oases of calm and tranquillity allow shoppers to peruse the meat and cheese counters at their leisure. Keep this all in mind with your designs – what do you want people to do naturally, unthinkingly and what do you want to stop them doing?

Here are a couple of additional pointers and considerations:

- i) **Emotional Space:** make your space comfortable and welcoming (using colour, fabric and lighting); with a good balance of privacy that doesn't inhibit connection; don't forget that comfort means different things to different age groups;
- ii) **Physical Space:** clear signage and layout to make it easy for people to find their way around (there is little more off-putting, disorienting or frustrating than arriving at a venue and not knowing which way you're expected to go); you also need to allow for practicalities like evacuation in the event of emergencies; you should and are legally required to provide access and toilets for disabled guests (ideally in a way that makes them feel as much like any other guest as possible); as well as allowing for sufficient circulation space at peak

periods (for example, if you plan to have a large conference room, make sure that when the meeting breaks for lunch, 1,000 delegates don't trample the Women's Institute luncheon guests in a stampede to the bar. The other sin that some architects are guilty of, is under-providing for linen storage and storage in general – it's not sexy, and doesn't generate revenue, so it can get ignored; however, having sufficient space for storage is crucial (make sure you're hot on this if you're not using an experienced hotel architect); both visible (to convey safety) and invisible security measures should also be included; keep in mind a lot of hospitality spaces will have multiple uses and the design should be kept flexible to accommodate this;

- iii) **Tech Space:** how can you use tech to create difference and ease of use of your property?
- iv) **Wellness Space:** Ideally you can make ease of cleaning and maintenance possible and invisible, while creating a hygienic environment at all times; connection with the outside world can also promote a greater sense of well-being (the opposite may also be true), and it may be possible to create it using ventilation, natural light, and biophilic elements; you can also assist people's well-being by making your facilities intuitive and easy to use;

From a design perspective, your description should be a combination of the technical design and a mood board that gives a flavour of the feel you're going for. If you have information on a specific site you're looking at, include it with as much detail as possible, and ideally with a site plan and map illustrating the relative location of nearby demand generators, competition and communications. If you don't have a specific site in mind, make a more generic *wish list* criteria of what you're looking for. I would include a 'strengths, weaknesses, opportunities and threats' (SWOT) analysis of the site if possible.

Here is my simplified Galleria Hotels example:

Galleria is a co-working campus hotel, comprised of 3 components:

- i) **co-working space** with hot desks, individual workspaces, and small team offices and soundproof 'call' rooms,
- ii) **hotel with related facilities** with Brewbakers bar & bistro, plus gym, self-serve laundry, games room and meeting rooms (bedrooms are called 'chambers' to signify their inside-out design that allows for meetings and working outside your bedroom), and
- iii) **central campus atrium** (with sound stage and a curated calendar of live events that unites it all).

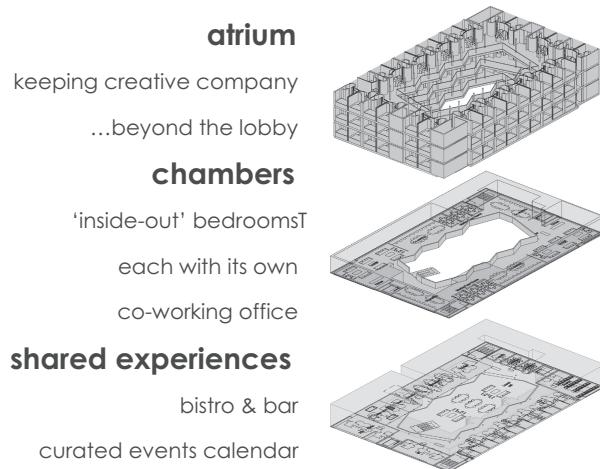
Brewbakers Bistro is the combination of brewhouse and bakery, selling freshly baked bread and patisseries in the morning, and hand-made pizzas cooked in woodfired ovens in the evening – served with craft beers, all made on site.



**Figure 6.3** Galleria Hotel interior designed by Bogle Architects



**Figure 6.4** Galleria Hotel in section



**Figure 6.5** Galleria Hotel exploded structural design diagram showing ground, mezzanine and upper floors

Galleria Hotels are currently in negotiations with regard to a site in Mumbai, and are looking for other locations around the world.

Target site locations are to be found within 20 minutes of the central business district, with access to good communications to the airport and other transport links.

Ideally, we look for derelict buildings or brownfield sites with a footprint of approximately  $20 \times 60$  metres =  $1,200\text{m}^2$  (0.3 of an acre) that can be developed to give a ground floor (double height) plus 3 upper floors (including a 1.5x height mezzanine). The site should be suitable to support a *sui generis* planning application/permission for short-term overnight accommodation, restaurant with bar (selling alcohol on premises only – no off sales), office and event uses.

You should also be specific about the range of facilities and put these into a summary schedule with a brief description of each.

## Brand, Marketing & Operating Model

At this point, it is also crucial to specify how you are going to operate the business (if you haven't already done so), under what brand and how you are going to get your offering to market. Are you going to employ a brand (through a franchise), with a *white-label* operator (or will you do the management); a branded

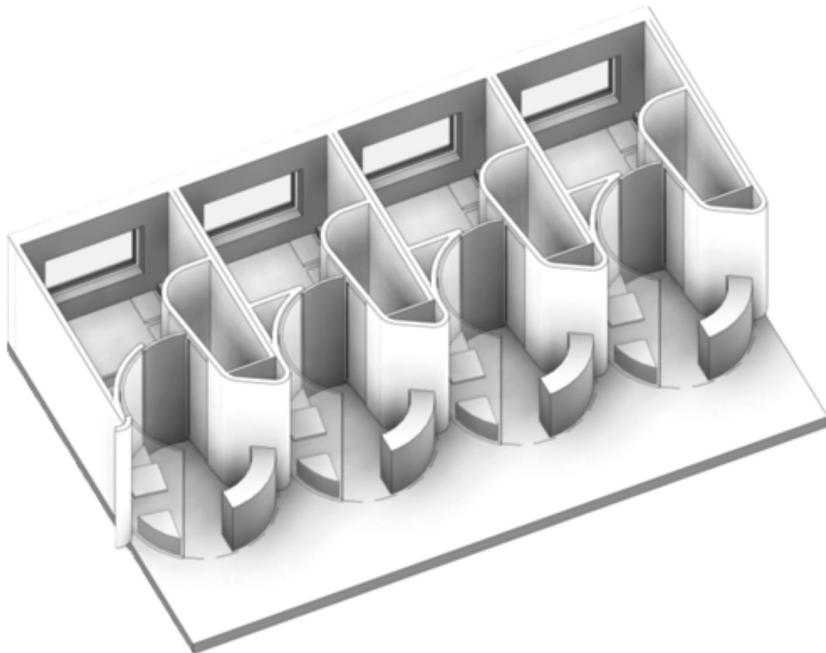


Figure 6.6 Galleria Hotels Innovative *Inside-Out Chamber* bedrooms

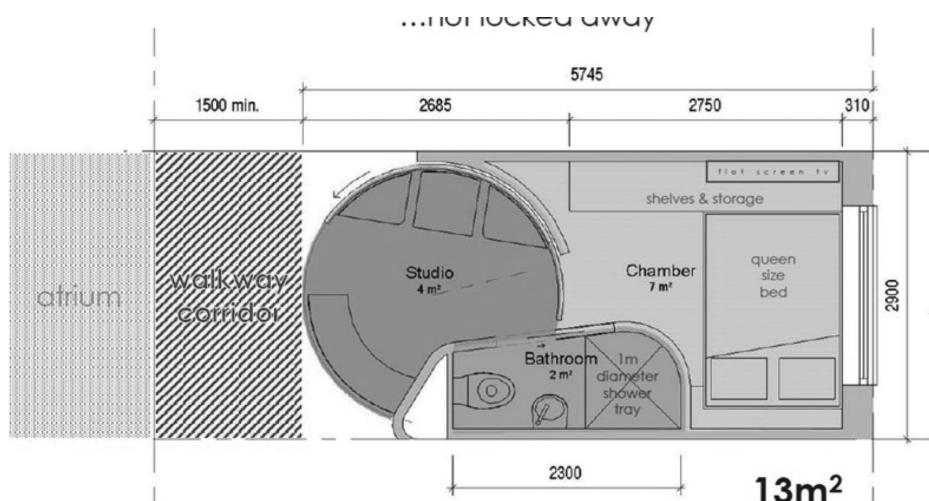
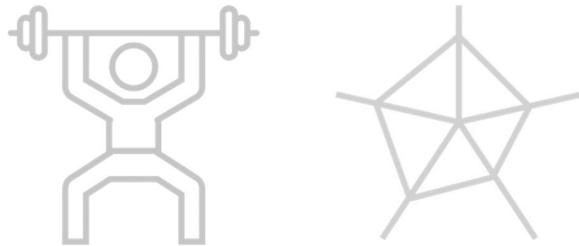


Figure 6.7 Galleria Hotels Innovative *Inside-Out Chamber* bedrooms: floorplan

| <b>Strengths</b>  | <b>Weaknesses</b>   |
|---|---|
| <ul style="list-style-type: none"> <li>• Defined Target Market</li> <li>• Reflects new work styles</li> <li>• creates community</li> <li>• creates collaboration</li> </ul> | <ul style="list-style-type: none"> <li>• unknown brand</li> <li>• high levels of competition from hotels</li> <li>• start-up</li> </ul> |



| <b>Opportunities</b>   | <b>Threats</b>   |
|--|--|
| <ul style="list-style-type: none"> <li>• grow niche following</li> <li>• target nomads</li> <li>• develop leisure offer</li> </ul> | <ul style="list-style-type: none"> <li>• new entrants</li> <li>• economic slowdown</li> <li>• substitutes</li> </ul> |



Figure 6.8 Galleria simplified SWOT Analysis

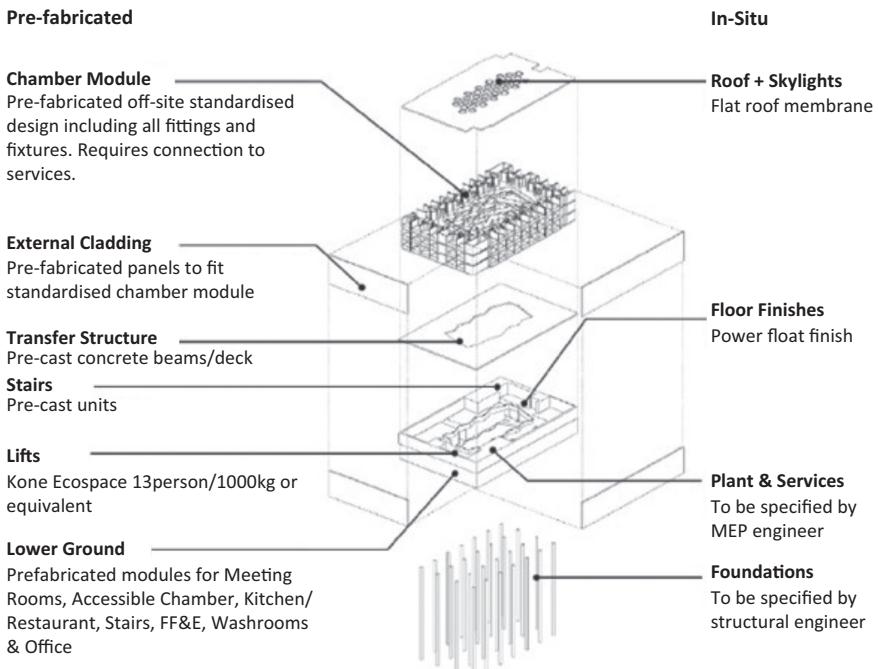


Figure 6.9 Galleria Hotels design and build strategy

| construction                       | operations                             |
|------------------------------------|--|
| 1. planning application lodged     | 1. pre-opening ops team assembled      |
| 2. detailed design phase           | 2. website & app developed             |
| 3. planning secured                | 3. Swisscom & Hetras integrations      |
| 4. ground works begin              | 4. PR & marketing contracts signed     |
| 5. slab & transfer structure built | 5. pre-opening sales commences         |
| 6. 2x51-module manufacturing runs  | 6. pre-opening training commences      |
| 7. modules delivered to site       | 7. pre-opening press "fam" trips       |
| 8. modules craned into position    | 8. GRAND OPENING                       |
| 9. roof & weather screen installed | acquisition to opening circa 12 months |

**Figure 6.10** Galleria Hotels construction and operation strategy

management contract (where the brand operator operates under one of their brands) or lease; owner-operation using and developing your own brand, possibly in addition to using a marketing consortium? There are advantages and disadvantages to each and you must decide and be clear how it's going to work. I would include commentary on the benefits and drawback of each, as well as a brief description of who the target audience is/where demand is coming from and how the selected operating and marketing mechanism is going to access them. All of this will be useful for your Business Plan.

## Writing a Business Plan

As with most things, simplicity is best – it is better to have a business plan that you understand and can navigate with ease. There's no point in having a document that is as alien to you as your concept is to your potential investors. You have got to own it and be confident in it. Use clear, unfussy language, '*Short words are best, and old words are best of all... Use simple words everyone knows, then everyone will understand.*' (Winston Churchill. 1940)

It should demonstrate your prowess, expertise and knowledge of the sector and your offering in it, but not be boastful or arrogant – that can make you look naïve at best or unbackable at worst.

It should also be something that stays with you all the way through the journey. It should be a frequently used reference tool, for yourself and/or any new senior members of the team you wish to induct into the business (alongside highlights of your brand book and marketing plan) – everyone should know, understand and buy into the basics of the company: the purpose of the business, its ethos and values, target goals and three key steps to achieving them. There are some very good templates out there for a one-page business plan, which can be expanded to suit your project needs and which will help you maintain the simplicity. If at the end of writing, you find that your business plan has grown into an unwieldy tome, you have a choice: trim it back to the essential elements, or keep it as it is and add an executive summary at the front end. Personally, I'd rather trim

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back to maintain the usability of the business plan, and then develop a separate documents for each section that can be pulled out in specific situations, as needed – rather like a reverse executive summary.

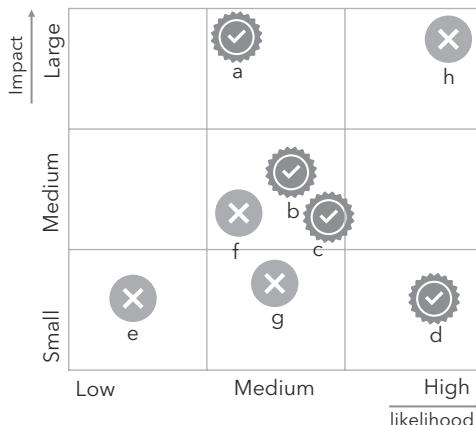
The structure of a simple business plan might be as follows:

### 1. The Pain/Problem and Your Solution

*User Focus* – what people are struggling with (give a little detail, maybe back it up by telling a short story to illustrate the problem and how your offering resolves it).

### 2. The Company

*Your Focus* – what you do and what is your competitive advantage or USP(s), how you came to be doing it. The range of products or services you offer, will offer. What price point/quality level. Who is the team? How are they qualified to do this? Some people go in for Vision, Mission, Values, Beliefs, etc. I'd keep it to a simple Purpose (as in no. 1 above), Strategic Goals (directional) and Objectives (SMART – specific, measurable, attainable, relevant, & time limited). SWOT, and a Ticks and Crosses Chart: size and position bubbles of opportunities and risks, ticks and crosses, on a graph of impact (y axis small to large) vs likelihood (low to high);



**Figure 6.11** Shows a ticks and crosses risk assessment diagram

a: get on booking.com

b: hot summer = sales

c: average TripAdvisor Score = >80%

d: £ weakens vs \$

- e: one-off storm
- f: new entrant to market
- g: inflation increases
- h: tourist tax imposed

### 3. Market Analysis

What is the size of the industry? How has it evolved over the past 10 years? How much has it grown and how much is it forecast to grow? What are the big events coming up that will impact the rate of growth or contraction? Who are the main players and what made them successful? How many competitors are there – what is the intensity of competition? Who are going to be your main competitors (if they're not the same as the big established players, explain why not).

### 4. Target Audience

Who are you targeting? Who is your ideal customer? Which broader segments are you targeting? Develop your customer personas (suggest not more than 5 otherwise it looks too scattergun).

### 5. Marketing Plan

Think Marketing Mix (Price, Product, Place & Promotion). Which distribution channels (social media, email, SEO, etc.) will you use to interact with your guests? Work out how will we: adapt to changing trends, build trust and credibility, improve engagement, maximise ROI, reach the right audience and stay competitive?

### 6. Timeline

What are the key points, milestones by which things will happen. Are there phases? How will these work? What does the critical control pathway look like? Maybe draw up a GANTT chart.

### 7. Summary Financials

I would take our P&L model, and if you need to simplify it, reduce it down (all figures for years 1–5): Headline Metrics (e.g. Occupancy & Rate or covers per hour) and Revenue Mix (e.g. Rooms: F&B, 50:50 split); total department costs; total overheads, with marketing budget broken down (+ any stand-out items); GOP \$ & %; any rents + F&F&E reserve and EBITDA. Maybe include a couple of sensitivities (this isn't worth going overboard on as any investor will do their own analysis, but it might be useful for you to help you anticipate the 'what ifs').

### 8. Funding

Development cost and breakdown. Timeframes. Anticipated loan terms and ROE & IRR.

## Presenting a Pitch Document

Make sure you have a concise pitch document (your business plan or a version tailored to your specific audience. Then remember all that stuff about communication. You may find public speaking a challenge, in which case I would seek specific help with this. I found reminding myself that '*it's my moment to take the stage and shine*', helped me own my presentation and not rush it. Similarly, there is no substitute for practice, try rehearsing out loud in front of friends and family. If nothing else works try a NLP public speaking programme – I took a very short course before I started my role as a radio presenter (radio presenting was great practice and great fun too! I wholeheartedly recommend it) and haven't looked back since (just be careful to select carefully, and check reviews for authenticity).

Be natural and relax as much as you can (6–2–6 breathing can help with this – breathe in for a count of six until you can't take any more air in, hold it for a count of two, and then breathe out for a count of six until you can go no further, repeat 3x). Pitch to the audience in the room – read the body language and mood. Be careful with jargon unless the audience knows your industry specifically (and don't assume they do). Know how long you've got to speak in advance and time it (check it is still the same when you arrive). Use Powerpoint if you absolutely have to or if your imagery can convey what you need to say more succinctly, but avoid death-by-Powerpoint presentations of over 16 slides. There are lots of resources out there for advice on getting Powerpoint right – find one that you relate to and use it. Most of all, avoid being un-investable – please don't dismiss the competition as irrelevant, make wildly optimistic projections that bear no relation to the market dynamics or pretend you can conjure demand from thin air without budgeting money to acquire it;

## Writing a Marketing Plan/Strategy

We have already skirted past this in the previous section and even though the actual marketing plan is a stand-alone item, I like to keep it short, particularly if you're writing it based on forecasting. You can always add flesh to the bones when you're underway and have live scenarios and data to work from.

Here is an example for you to start with (adapt and expand it as you get more information or ideas that will help you achieve your goals):

### 1. Business Summary

Very short to set the backdrop to the business and the marketing team.

### 2. SWOT

I believe in 'S&W' of SWOT being internal and 'O&T' being external e.g. Strengths: what we do well, why our guests choose us; Weaknesses: what

can we improve, what needs fixing; Opportunities: industry changes, what is our USP/differentiator; Weaknesses: increasing competition, changes in legislation. Check out examples online for a fuller idea.

### 3. Initiatives

Number your proposed activities and outline them: Description – e.g. *get placed PR piece in newspaper*

Goal – what is the objective of the initiative?

Measurement – what does success (or degrees of success) look like? How are you going to measure it?

### 4. Target Market

Who are we going to target?:

Sectors and sub-sectors;

Buyer Types – develop personas:

- 1 *use a picture of a typical persona – make it real!*
- 2 *populate demographics – job, career stage, family situation, age, income, lifestyle? personality traits?*
- 3 *what are their life/career goals/challenges? What are their life quotes?*
- 4 *how can we help achieve/overcome these? What don't they like about us, what might they object to?*
- 5 *What is our marketing message to them? What's the elevator pitch?*
- 6 *what are their communication preferences (which socials, email, etc., what media do they buy? (magazine, TV, streaming, cinema, etc.)*

### 5. Competitive Analysis

Who are our direct competitors?

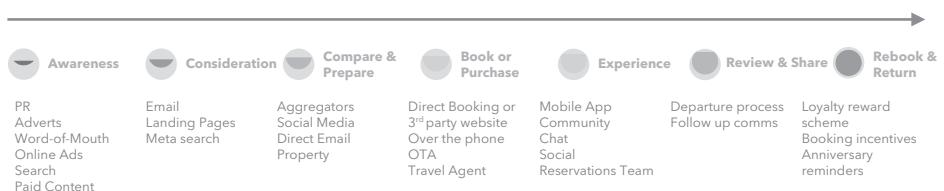
Who are our indirect competitors or substitutes? (*a friend at a major international hotel company, discovered the main competition for their two-week holiday package, was a new kitchen*), think laterally!

Where do we compete with them? meta search? press? socials?

### 6. Marketing Mix

Product – describe your offering, why it's better, how you'll enter the market both in terms of initiatives and in terms of positioning (think personas). Also, how is it delivered to the guest (obviously they're coming to your location to enjoy it, but how are they getting there and how will you present and serve it when they arrive?)

### Guest Journey Map -Simple Example



**Figure 6.12** Guest journey map example

Price – what is your pricing strategy (there are entire books just on this, so unless you've invented a new way to price your offer, I'd keep it simple – is your price competitive with the market, does it fit your guest budget and what are you going to do to attract demand at special times, and when?)

Promotion – place adverts? PR? etc.

Place – is worth looking at separately under no. 8. As a refresher, it's where and how you sell your offering to your guests i.e. what are your distribution channels?

It can be helpful to draw a customer journey map as shown in Figure 6.12.

#### 7. Budget

Set a budget for how much you anticipate spending on each of your initiatives and elements of the market mix + your payroll costs.

#### 8. Marketing/Distribution Channels

What is the channel? e.g. content marketing for awareness and retention (articles, podcasts, videos); direct marketing (billboards, print media, TV); email marketing; influencer and social media marketing (build relationships and promote brand); SEO to be found online/when searched; and the cheapest and best word-of-mouth sites to encourage and reward guests to recommend you to others, mostly by doing what you do really well and asking them to talk about it on social or review sites.

#### 9. Technology Strategy

What tech are you going to use and how? (AI? advert management software, blogs, CRM, email, marketing automation software, social media management/automation software, podcast software, video hosting software. Set a budget for how much you anticipate spending on each of your initiatives and elements of the market mix + your payroll costs.

## Protecting Your Idea

Realistically, it is very difficult and expensive to protect an idea or your intellectual property (IP), even though there are international laws and conventions that are supposed to help. You can start by getting people to sign an NDA (non-disclosure agreement), but be mindful these are usually limited in their scope and timeframe. If you think you might have an idea that is worth protecting, you should check to see if you it really is original or just a variation of something else. If it is truly original, make a list of all the different elements that are original and record evidence of when you invented it or came up with it (some people mail themselves packages containing documents that evidence this, as it provides date/time stamped proof – just never open it!). You can copyright tangible works (written etc.) but not the idea per se.

You can register a domain name for your business and/or a company (if someone copies your company they might be guilty of passing off). Otherwise, there is some protection if you register trademarks (for logos, brand names etc.), patents (for designs or inventions), but be aware that to be comprehensive and global in nature, the cost of this can run into the hundreds of thousands. Even then they may be difficult to enforce in some jurisdictions, as James Dyson et al have discovered. You can break up manufacturing processes to stop one supplier having all of the design information, but by far the best way to protect your ideas is to be a) first to market and scale rapidly, and b) build very robust relationships with your suppliers and customers, as well as internally – it is impossible to get back time and very difficult to copy a long-standing relationship, particularly if the person you're copying is still in it!

## Chapter

# 7

# DEVELOPMENT APPRAISAL

## Validating Your Project

### Project Description

All real estate development starts with a Development Appraisal – a practical and financial assessment of a property's potential value for development. I suggest that because the occupying hospitality business is fundamental to the value of the project and property, this should always be combined with a market and financial feasibility study that assess the market demand, competitive environment and guest-oriented characteristics, too. Thankfully, because we've already looked at the construction of a P&L, understood how to write a business plan, a marketing strategy, and written the project concept, this should be a breeze.

These reports usually weigh in at around 70 A4 pages (after all of the caveats, disclaimers, indexes and glossaries), and they usually start with an introduction to the project. You can take yours from your Project Concept and insert it here.

### Location Assessment

There is an old saying in surveying and feasibility work, *you have to wear out the shoe leather*; in other words, you have to visit the site and approach it from as many different directions as possible, only then will you get an appreciation of how it will sit in its surroundings and how guests might feel as they come for the first

time. You also have to *pound the pavement* of the surrounding neighbourhood to see where the competition is and how it presents to the target audience. It can be expensive to visit your target location, but it is invaluable, so try and make time to measure distances personally on foot, by car or whatever is appropriate, in the actual conditions (not just using online maps). As good as it is, Google maps cannot tell you how dusty an access road is or how unsafe it feels, nor can it convey what it's like to wander around in the midday sun or during a tropical downpour. Take pictures for your report and to aid your memory, of approaches, competitor establishments, demand generators (including significant business-related activities and tourist attractions) and other relevant points of interest (POIs), at different times of the day and night (or as much as you can without getting into trouble, as different jurisdictions have different regimes in this regard – for instance, I have been pursued by an armed policeman when taking photos too close to government buildings).

The key things to keep in mind:

- i) Is the site visible, from all directions? (or will signage be from its roof once built).
- ii) What is the terrain like? (if it's very sloped, for example, it will likely add to the cost of development; cut-and-fill is expensive).
- iii) What is the surrounding area like? (Are the buildings tumbledown and overgrown with weeds? Could they endanger the site? Is the site located in a busy district or on its edge, or in between, or nowhere near? Is it an up-and-coming location or down-at-heel and getting worse – how much are you going to have to spend to persuade people to visit or make them feel safe or is it a busted flush?). Is there water nearby? Is there sufficient drainage? Is there water and power to the site? Is the site polluted and is there pollution in the area? Are there rights of way across the site? Does the site have planning permission?
- iv) How easy is it to get to, using different modes of transport: on foot, by road – it's different for taxis and private cars; how close is the nearest railway station and where does the trainline serve or get you to? Is it single line or high-speed, local or international? Where is the airport; again, is it a regional provider or international hub? Same for sea, as appropriate. In most instances you can use publicly available data on passenger movements and services for air, rail, and sea if you look hard enough. Governments are always keen to publish anything that demonstrates they're improving access and communications. Note down journey times to and from main attractions and communication points (stations, airports) by foot and car (if relevant).
- v) Gather data on the population and verify it by doing the *chimneypot check* - look at the extent of high-rise building or lack of it, what does it feel like in

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terms of density? Is the population diverse, affluent or poor (what is the average salary/wage?), what is the employment profile – is it mostly manufacturing workers with a few managers, or is it a commercial centre with office workers? You can usually get a breakdown of a region's economic structure online (CIA World Factbook, Wikipedia, etc.), which will tell you how much of the economy is dedicated to mining, utilities, retailing, hospitality, farming, finance, public administration and healthcare etc., and each of these carries a lot of information about the availability of the disposable income that is possibly available to your potential guests.

- vi) Notice proximity of the site to key development projects (new offices, arenas, stadia, regeneration projects, large-scale civil engineering or regional infrastructure developments – these will all generate demand for food, beverage and accommodation at some price point – find out when they will start and finish).
- vii) Gather data from official sources on visitor data – again, governments will usually be proud of the collection of this sort of data and the success of their efforts to bring visitors and related investment into the location. Useful information will be on the origin of tourists, purpose of visit, volume of visitors, average length of stay, average spend and how all of these have changed and are forecast to change (all of this information will feed into our fair share model).

## Situational Analyses

Before, during and after you've done your site review, location summary, supply and demand analysis and financials, it's good to keep in mind a couple of the good old situational analyses that help to guide your thinking. Most people start with a SWOT (which we've now done to the point of tedium) and then some will follow up with a PESTLE and fewer still, a Porter's Five Forces:

**PESTLE** Analysis (an extension of PEST) that encourages you to consider macro factors:

Political – e.g. stability, trade and tourism policy, taxation;

Economic – e.g. economic growth, exchange rates, inflation;

Social – e.g. crime/health statistics, demographic changes;

Technological - e.g. automation, innovation, internet speeds;

Legal – e.g. employment laws, copyright, consumer law;

Environmental – recycling, climate readiness, weather;

**Porter's 5 Forces / Hospitality's 6 Forces** is a framework for the competitive dynamics of an industry, as amended for the hospitality industry:

1. **Competitive Rivalry** – Customer Loyalty, Number of Competitors, Product Differences & Quality Comparison, Switching Costs (what does it cost a guest to leave you for a competitor? Amazon Prime is a great example of a business creating a switching cost);
2. **Threat of New Entrants** - barriers to entry, cost advantages, economies of scale, specialist knowledge, technology & time;
3. **Supplier Power** – ease of switching between suppliers, number of suppliers (competition between them), size of suppliers (market dominance) & uniqueness/tailoring of service they offer;
4. **Guest Power** – ability to switch to another provider, cost of switching, difference between providers, number of customers (buyer or supplier market?), typical purchase size & price sensitivity;
5. **Threat of Substitution** – substitutes (as per the example of a new kitchen vs a 2-week family holiday), could just as easily be AirBnB, homestays, etc;
6. **Complements** – technically, where the increase in cost of one offering reduces the demand for another, although we can expand this to a more positive perspective of businesses working together to provide mutually beneficial, coherent, enhanced offerings to guests e.g. a resort does a deal with the specialist fish restaurant next door so that guests can charge meals purchased there to their room.

This element is normally recognised as only being an influence on the market, whereas here I have elevated it to a market force, because so much of what we do in hospitality is linked to other things that complement our businesses or are in between us and our guests).



**Figure 7.1** Porter's Five Forces Adapted for Hospitality

## Competitive Supply and Demand Appraisal

While you're in the location, it is also important to get an accurate feel for the existing competition and any new competitive arrivals, including when they are expected to open. In some locations I've been to, there are reports of tens of hotels scheduled to open, but when you walk around the city it's littered with half-built, or incomplete projects that never made it beyond cold shell and core (so it is a good idea to see if there are workers actually on site, whether fresh materials are arriving and most reliably, whether the developer has started on fit-out (i.e. the building is glazed, has a roof and equipment/soft furnishings are being installed).

Competition is not necessarily a bad sign, indeed sometimes you can get a clustering effect in a location that creates a critical momentum in its tourist development (availability of trained staff, alternative hotels or F&B offerings etc.). Competition can signal demand if the properties are busy, or it can signal a market in decline if they're not. While it is unlikely that you'll be able to stay for 365 days, it is important to get a balanced year-round perspective by talking to people on the ground – *is it normally this quiet here?* I've lost count of the times an optimistic client has said to me they know their hotel will do well once they've built it, simply because every time they visit the Hilton on the opposite corner, it's packed. Hmm, maybe they're right, but I need more information and more convincing – remember if a hotel is full on one night and empty the rest of the week, it will achieve 14% occupancy, which is probably less than a third of its break-even figure (and that's without factoring in what the international branding of that Hilton does to boost performance).

There is nothing else for it, you're going to have to get out there, wear out more shoe leather and visit as much of the competitive supply as you can. In locations where the supply is plentiful, I'd advise making sure the competitors do indeed represent competition to your business, in terms of type, style, age, range of facilities, published price, branding, specific location, and so on. Then make as many appointments as you can to meet with the owner, general manager or sales and marketing manager. Most will be unavailable (they're busy people and unless you're a potential guest they've got to focus their efforts elsewhere). Don't be put off, turn up and ask reception if it's possible to see a room or the layout of the property (at this stage I wouldn't be too specific about why if you can avoid it). Then if you get a show round you can interrogate the person showing you around as you go. Be polite and genuinely interested, asking leading questions, like *it looks busy, have you got an event on or is it always like this?* Don't ask your guide directly for key metrics, they probably won't know the answer and you'll immediately make them suspicious.

Once you've had your tour, you can ask if you can meet with the appropriate manager (go for the ones mentioned above, and if they're still not available, speak to anyone – it's all potentially important information and you just never know where you'll

find the diamond in the rough). When you have your walk around make mental notes of the condition of the rooms and public areas, especially any bathrooms and plumbing, as well as the amenities provided (air-con, mini-fridge, phone, satellite TV, safe, etc.). Ask yourself, are they being kept clean, and up-to-date? Are they being used a little or are they used a lot and showing signs of wear and tear? I'd recommend timing your visit outside of busy periods if possible; otherwise, the operations team just simply won't have bandwidth to spend time with you. If you do get a meeting with one of your targets, go gently, but be aware of time: they don't want you sitting there taking up their time being vague about why you're there and what you want to know (refer back to the negotiation section of this book for help on this). What is vital to get is the number of bedrooms and an idea of when the property is busy in the year and each week. The displayed prices will tell you a lot about average spends or rates, but you may be able to get more if you ask the right questions in the right way. Most of the time, you'll end up trying to extract quantitative information to supplement your own qualitative assessments. Don't forget to look at the car park and count cars if it helps. Hotels are also getting better at not displaying which conference suite the UN delegation is in, but some still do and if you find out things like that, you know a) there's a UN delegation – where else do they go? (do they have a permanent station here?), and b) they're paying a per diem rate for accommodation and F&B; stop by their offices for a chat and see if you can get what that is, it all helps.

I find it invaluable to draw a map of the location and mark on it where all of the competitor properties are in relation to yours, and where the main POIs and demand generators are, as well as the location of key transport links.

## Demand Analysis & Using Third Party Data

So, you've done your site visit; now it's time to get into the detail of the data you've gathered. Ideally, in a market where there is a lot of information, you can build a profile of how the supply of bedrooms or restaurants, etc. has evolved over the last few years, and quantify its size today. You will have also picked up data on what competition is coming down the pipe in the next few years. Balance this in the supply and demand equation and you can estimate what fair share occupancy is (see the 'Building a P&L' section). If you can, it is worth estimating the % of global, international, national and regional brands, as well as the % of independents in the market. Further, you can look at the average size of hotel and note the breakdown by hotel size within the market, making sure to include businesses of a similar nature and scale to your proposed property. It can be helpful to draw up a table detailing the comparative number of bedrooms, branding, facilities and quality level.

If you're lucky with the availability of data, you can do a detailed analysis on the demand side, too, to give you data that can be transformed into illustrative graphs, etc.

Often, this quality of data is only available from proprietary sources like CoStar (STR) and HotStats and is only available at a cost. It is usually worth the investment, because it really gives you something concrete to work with rather than mere estimates. Just be sure that you get the data set right or your money will be wasted. I once saw a feasibility study, conducted by a reputable global real estate consultancy, where they had used purchased information, but had chosen the competitive set poorly – the proposed hotel was to be an upper-midscale offering (projected ARR of +/- \$150) and they had included 3 economy hotels into the set (ARR circa \$50). Their analysis was rendered entirely irrelevant and useless, simply by not specifying their requirement properly.

## **Updating Your Project Concept**

As we have discussed, it is important to keep updating your project concept as and when you are able to add more detail and insight. It is a process of constant improvement (except during the project management and construction phase, when a design must be frozen so that it can be accurately specified, costed and built).

## **Financial Modelling**

We have covered the financial modelling already; the only thing I would add here is that you might want to gather information on borrowing costs and terms in the local environment, as well as land and development prices during your field trip. You should also provide commentary with your financial projections that clearly state your assumptions (for yourself as well as for any potential investor). At the end of the day, the financial viability of the project is crucial – if it doesn't stack up, it will be dead in the water. And the financial viability hinges on two things, market demand and development costs (with the skill of the operator in driving demand and converting revenue to profit, plus the skill of the construction team to deliver on time and on budget sandwiched in-between).

As a side note, there are different ways to value a hospitality project; we have looked at one where we project and value the expected cash flows of the business once it is built and trading. Other methods include a cost approach, when the cost of building or replacing the development is used. Another approach might be to compare the value of your development to similar ones that have been recently bought or sold (their value is set to a degree by the market – what a willing seller was prepared to pay a willing buyer).

# Chapter 8

## PROJECT MANAGEMENT

### Developing Your Project

#### Acquisition

Like the lady said, real estate is all about “*location, location, location*” (or *pitch, pitch, pitch*). Good real estate for you, is real estate with a good location for what you want to do. The value of real estate is down to how broadly its potential use can be applied, in the many buyers vs limited supply/scarcity frame. Buying land today is extremely complex when it comes down to the details. However, that doesn’t mean that you can’t do the top line stuff yourself. It’s better to have conducted thorough research on a potential acquisition before you spend money on legal or other professional services – it is rare that you can get those fees back if the purchase turns out to be a dud. So do your research and get as many perspectives as you can (provided you’re not weakening your negotiating position). Do your due diligence.

Map your investment and acquisition strategy – know precisely what you’re looking for in a property, and what you can flex should you need to. Know what you can afford to pay for the acquisition, against the cost of any works you’ll need to conduct to bring it up to the standard you’ll need to sell the offering to your guests. I spent years in the run-up to the global financial crisis, chasing around looking at potential hotel acquisitions that appeared viable, but that in the end weren’t. You often don’t have any idea how much you’ll need to spend on a refurb, until you’ve looked under the hood and discovered that the previous two owners

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have cut corners, not done the maintenance properly and flogged the building half to death. Then your estimates of occupancy and how much you can expect to charge your guests looks woefully inadequate...and then your carefully prepared financials fall apart – *“Everyone has a plan until they get punched in the face”* (Mike Tyson, 1987).

Unless you have lots of experience buying property, I strongly encourage you to get professional support as soon as you've decided on a potential target. Even then, it's a good idea – the more brains the better.

Finally, consider if how the acquisition is to be conducted:

- Auction
- By private treaty
- Development Agreement
- Direct Partnership (i.e. Joint Venture)
- From Government Agency
- Leasehold (various)
- Outright Purchase
- Public Private Partnership
- Purchase of Rights

Consult your experts on this.

## Operator Selection

As you will be bored of hearing by now, the performance of your hospitality business is fundamental to the value of the underlying real estate. Therefore, who and how you operate that business is crucial. A small operation with a handful of rooms will be unlikely to warrant (or financially support) the engagement of a brand and/or management company, so you're going to have to do it yourself or hire a manager. Do you have the skills? Can you acquire them? – of course you can, it's not rocket science, but it does require dedication. Be very careful in your hire if you choose to employ a manager; obviously do background checks and so on, but more importantly ascertain whether they match or are at least sympathetic with your brand ethos. If it's not natural to

them, it's hard to teach, and you'll be expecting them to be the face of your brand both externally to your guests and internally to the rest of the team. If you're going to be the manager, this will be you – so make sure you're living and breathing it – if your brand identity is all about say, enjoying the outdoors, I expect to see you out every morning attacking the next trail (if that isn't you at your core, it is going to be doubly difficult to be consistent when you're under pressure).

If you decide that appointing a management company is a good idea and is affordable, then you need to decide, what sort of company and how you are going to engage their services. You may decide to take a franchise and employ a white-label manager (as we've looked at in *Place*), or you may choose to try and secure a management contract directly with the brand (who will badge it and run it for you). These days, management contracts are getting rarer, as big brands move to their asset and people-light operating models (as they pretend to be tech companies). There are cost implications to both, as we've discussed previously. Just don't get dazzled in the headlights when a big brand offers you a management contract, and equally don't be surprised if they don't. Either way, there's a pathway to follow in operator selection. I highly recommend appointing an architect to draw up a sketch-scheme with an outline specification of the development before you get to this stage, as it will help you identify suitable operators as well as explaining your concept to them. All done, next draw up a long list of potential operators and reach out to them asking for proposals (you can have informal calls with the heads of development at a few of your favourites in advance of this, to make sure you're going to get some replies – you'll also learn a lot about what they think about your site location and umbrella plan, as well as some of the questions to ask of other operators). Once you have your replies from your long list, you'll quickly move to a much shorter list (if you don't get any, it may be time to question whether what you're proposing really is a good idea, after all). Once you have established those who have a genuine interest, you'll have to sort the sheep from the goats and to do this you'll need more information to compare proposals. As ever, different people have different ways of approaching this. I use the following template (usually in a spreadsheet) as shown in Figure 8.1.

Having conducted this exercise, you can make an informed decision on which ones you like the best and which ones tick the most boxes. Just keep in mind that today's individuals may not be the ones running your operation in a year's time – it's traditionally a very transient industry, so look beyond the team sitting in front of you.

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| Item  | Operator Response | My Score (out of 5) | My Comments |
|---|-------------------|---------------------|-------------|
| <b>Company Overview</b>   |                   |                     |             |
| Registration  |                   |                     |             |
| Name  |                   |                     |             |
| Number  |                   |                     |             |
| Date of Reg.  |                   |                     |             |
| Jurisdiction  |                   |                     |             |
| Years in Business   |                   |                     |             |
| Key People (service terms)  |                   |                     |             |
| Board   |                   |                     |             |
| Senior Management   |                   |                     |             |
| Corporate Performance   |                   |                     |             |
| P&L   |                   |                     |             |
| B/S   |                   |                     |             |
| Solvency Ratio  |                   |                     |             |
| Credit Rating   |                   |                     |             |
| Scale of Operation  |                   |                     |             |
| how many hotels in UK   |                   |                     |             |
| scale   |                   |                     |             |
| style   |                   |                     |             |
| quality   |                   |                     |             |
| locations   |                   |                     |             |
| branding  |                   |                     |             |
| Branding  |                   |                     |             |
| Target to be branded  |                   |                     |             |
| Brand Proposed  |                   |                     |             |
| Why Brand   |                   |                     |             |
| Why Not Branded   |                   |                     |             |
| <b>Marketing</b>  |                   |                     |             |
| Team  |                   |                     |             |
| External Support  |                   |                     |             |
| Size of Corporate Database  |                   |                     |             |
| How Many Large Corporate a/cs                                     |                   |                     |             |
| <b>Service Support</b>  |                   |                     |             |
| (in relation to Operations, S&M, Revenue Mgmt., Finance, IT & TS) |                   |                     |             |
| Corporate HQ Support  |                   |                     |             |
| Number Staff by Dept.   |                   |                     |             |
| Division of Resources/Property                                    |                   |                     |             |
| Location  |                   |                     |             |
| Frequency of Contact  |                   |                     |             |
| Pre-Opening Support   |                   |                     |             |
| <b>Ability to Perform</b>   |                   |                     |             |
| Pipeline (MoU/HoT signed or under construction)                   |                   |                     |             |
| Performance Against Competitive Set                               |                   |                     |             |
| Track Record of Success (rooms & non at comparable)               |                   |                     |             |
| <b>Pro Forma</b>  |                   |                     |             |
| Occupancy %   |                   |                     |             |
| ARR £   |                   |                     |             |
| RevPAR  |                   |                     |             |
| F&B Revenue   |                   |                     |             |
| F&B Mix %   |                   |                     |             |
| Other Revenue   |                   |                     |             |
| Total Revenue   |                   |                     |             |
| Cost of Sales   |                   |                     |             |
| Food  |                   |                     |             |
| Beverage  |                   |                     |             |
| Payroll   |                   |                     |             |
| GOP   |                   |                     |             |
| EBITDA  |                   |                     |             |
| Proposed Head Count   |                   |                     |             |
| Anticipated Staff Turnover Ratio                                  |                   |                     |             |
| <b>Operational Offer</b>  |                   |                     |             |
| Lease   |                   |                     |             |
| Management Contract   |                   |                     |             |
| Franchise   |                   |                     |             |
| <b>Provisions &amp; Key Terms</b>                                 |                   |                     |             |
| Term  |                   |                     |             |
| Fee Structure   |                   |                     |             |
| Budget & Spending Restrictions                                    |                   |                     |             |
| Restrictive Covenants   |                   |                     |             |
| Performance/non-performance clauses & Termination                 |                   |                     |             |
| Other Key Clauses   |                   |                     |             |
| <b>Financial Support</b>  |                   |                     |             |
| Key Money or Other Contributions                                  |                   |                     |             |
| Equity Investment   |                   |                     |             |
| Lender Support (existing relationships)                           |                   |                     |             |
| <b>Operator Comments</b>  |                   |                     |             |
| Suitability of Proposed Facilities                                |                   |                     |             |

**Figure 8.1** Shows the typical considerations in an operator selection process

## Assembling the Design Team

Developing a hospitality location is potentially complicated and can involve multiple different players, each of whom will have their own ideas and agendas:

Architect

Building Contractor

Developer

End User/Occupier

Funder

Landowner

Lawyer

Letting Agent

Local Authority

National/Regional Government

Planning Officer

Project Manager

Site Agent

Surveyor

Visitors/Guests

It's helpful to know who is on your side! (and how to handle those who are not – advice from your team will be invaluable on this). There are lots of moving parts and it is helpful to understand the different roles and where they sit in relation to each other.

Your first big decision that will involve the senior members of all your teams is your procurement methodology or procurement route. This is how you will get the construction work done and is dependent on your risk strategy and cost considerations. The choices are:

**Traditional:** (aka design, bid, build). Developer appoints consultants to design the project in detail (including drawings, work schedules and bills of quantities) and invites contractors to tender for the work. The contractor is not involved in any of the design (except possibly for small temporary elements) and merely quotes to complete the work as specified. This is the most often used method,

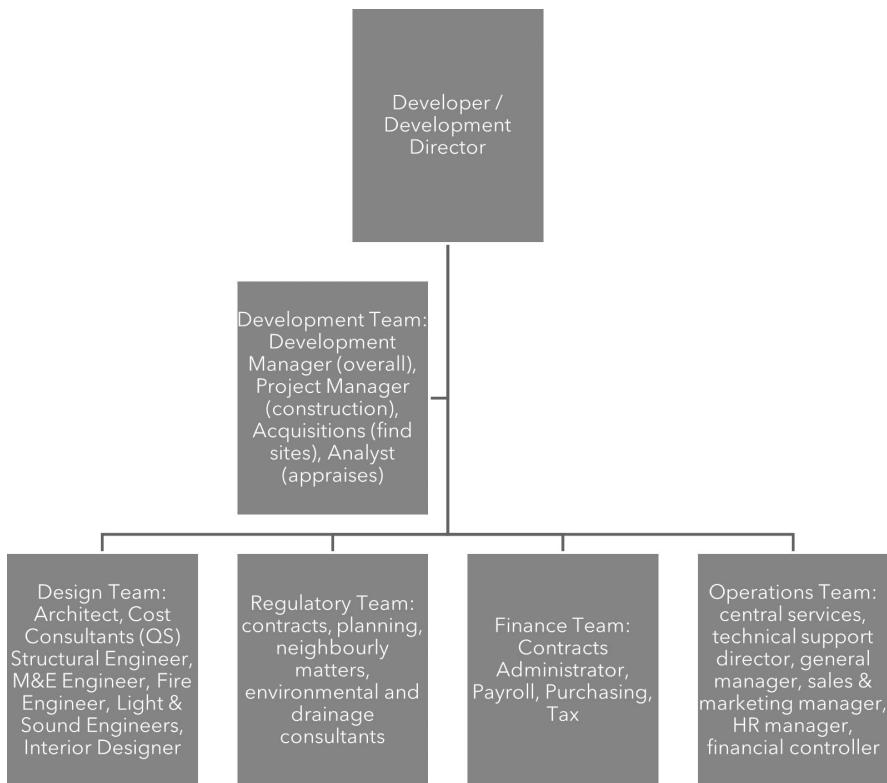


Figure 8.2 Example of a development team structure

predominantly when the developer wants to specify the design very precisely. If the project is complex or there are a lot of unknowns (soil structure etc.), the contractor will likely price these into their tender bid – as we have seen, where there is risk there is cost.

**Design & Build (D&B):** 1 or 2 stage D&B, where the contractor is responsible for both design and construction. In a 1-stage D&B, all design information/specification is provided upfront, whereas a 2-stage contract will typically involve less detail in the design to allow for greater overall flexibility and input from the contractor. This is where the developer is less concerned about specifying the detail of the design and is happy to involve the contractor. This may be a better solution where the developer wants greater certainty of the end cost of the construction, as the contractor quotes a fixed price. This is also subject to risk factors being priced into the system.

**Management Contract/Construction Management:** this is where a construction manager (in house or contract) oversees a number of other subcontractors to complete the construction on behalf of the developer. This is often used in situations where time is less of a constraint and there are a lot of unknowns. The construction manager joins the team at the beginning and assists in developing the construction plan to accommodate or mitigate the uncertainties in advance, and as far as is possible. The risk is priced in by the in-house team and so there is less potential for overstatement of the potential risks.

**Cost Reimbursable Contract:** (aka cost plus contract) the contractor is reimbursed the actual costs they incur in carrying out the works, plus an additional fee.

There are a number of other methods, but these are the main ones.

There are a number of different project management approaches that can be applied in construction, and the best one I've come across is the one from the Royal Institute of British Architects (RIBA) in their Plan of Work (2020). This plan breaks down the development process into eight stages, summarised as follows:

**Stage 0: Strategic Definition** – gather client requirements, develop business case, review of risks and budget.

**Stage 1: Preparation and Briefing** – prepare project brief, quality aspirations and special requirements, undertake feasibility studies and agree project budget.

**Stage 2: Concept Design** – prepare architectural concept (including strategic engineering requirements and aligned to the cost plan, project strategies and outline specification.

**Stage 3: Spatial Coordination** – undertake design studies, engineering analysis and cost exercises to test architectural concept resulting in spatially coordinated design aligned to updated cost plan, project strategies and outline specification.

**Stage 4: Technical Design** – develop architectural and engineering technical design, prepare and coordinate design team building systems information, prepare and integrate specialist subcontractor systems information, prepare stage design programme.

**Stage 5: Manufacturing and Construction** – finalise site logistics, manufacture building systems and construct building, monitor progress against construction programme, inspect construction quality, undertake commissioning of building and prepare building manual.

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**Stage 6: Handover** – hand over building in line with plan for use strategy, undertake review of project performance, undertake seasonal commissioning, rectify defects, complete initial aftercare tasks including light touch post-occupancy evaluation.

**Stage 7: Use** – implement facilities management and asset management, undertake post-occupancy evaluation of building performance in use, verify project outcomes including sustainability outcomes.

There are multiple resources available to help with this on the RIBA website.

## Other Project Management Methodologies

There are multiple general use project management methods including Agile, Critical Chain, PMP (Project Management Body of Knowledge), PRiSM (Projects integrating Sustainable Methods), Prince2 (PRojects IN Controlled Environments), Waterfall, as well as lean versions of most. However, the two tools I consider most useful to use in conjunction with the RIBA approach, are the GANTT chart and the Kanban Board.

The Gantt chart was invented by Henry Gantt and is effectively a horizontal calendar that shows the work to be done under different headings. Various mind-mapping or project software will make Gantt charts for you based on the list of items that need to be completed. The Gantt is a very useful visual representation of the planned progress of a project that you can check off against as you progress.

The Kanban is similar in that it turns a list of tasks into a visualisation and can be used by itself for smaller projects, as a useful way to stay on top of your ‘to dos’. Microsoft Planner is included in its Office package and is as good as any I’ve used.

## Pre-Opening

It’s six months from opening. Construction is underway and everything is going well. You’ve got your management approach sorted and now is the time to really get into activating the operational side of things. First, you should engage your general manager or GM (if you’re using a management company, they will offer you someone to fill this role, and you should have the right to approve or reject their chosen candidate – we’ve already mentioned how important it is to get this hire right). The GM should then, in consultation with you, set about preparing an operating plan that drops out of your original business plan. The next person to bring on board is your Finance Director/Controller (FD/FC), who will oversee pre-opening expenditure and will prepare detailed operating forecasts for the property through pre-opening and once it opens. Then your Sales and Marketing

Director, who will work closely with the GM to prepare a detailed marketing plan and oversee the website development, Google business profile registration, and negotiating terms with OTAs and other suppliers, etc. The other really important function of the Sales and Marketing Director is to plan the Grand Opening, to get press, selected guests (local grandees, celebrities and influencers) all there for the big night. The GM will probably want to do a soft opening (anything from a week to three months) before this, when processes can be practiced and wrinkles ironed out. At around the same time, you need to get your Human Resources Director/Manager on board to prepare for the rest of your hiring needs, which can be a lengthy and difficult process (writing employment contracts, staff manuals, training programmes and delivering these as well). Sometimes larger businesses will conduct overseas recruitment drives where labour costs are lower and there is an abundance of qualified workers. Depending on how you intend to run the property, now might be a good time to hire your IT specialist. The hospitality IT sphere has gained in complexity almost out of all recognition from when I first started in the industry. Many of the tools now available to operators are extremely useful if deployed correctly and when the correct training is given. The Shiji Group has a hilarious infographic that illustrates exactly how complex in-house IT systems have become.

## Working Capital

All of this activity will incur costs and require funding. The projects I have worked on typically budget for between 3–6 months of operating costs for this, subject to the scale of the property and duration of pre-opening. Depending on what you've negotiated, you may want to include working capital in your construction budget.

## Opening

You made it and it is grand opening night! Make sure this is well planned and goes smoothly – it is the first and one of the largest opportunities you'll have to drive awareness to your guests; make the most of it.

# Chapter 9

## ASSET MANAGEMENT

### Once Your Project is Operational

#### Treasure Hunt for Value

Even if you've owned your property for a while (or you've already done it once right at the beginning), it is never too late to go through it on a treasure hunt for value. What does that mean? Looking for opportunities to add revenue or reduce costs. If you imagine that each square foot of your floor space has a \$ and the number of how much you've paid for it written in the middle of it. Then think whether it is earning its value back or continuing to cost you more. I have worked on projects where we put a cell phone tower on the roof and in doing so, earned a generous rental income from the telephone company. We did make the building look uglier in the process, so be careful how you go about your treasure hunt. The most famous example, however, was the luxury hotel on Park Lane in Mayfair (some of the most expensive real estate in the whole world) that was discovered to have 30 staff bedrooms on the top floor overlooking Hyde Park. This staff accommodation was saving the hotel the equivalent of around  $30 \times £500$  per month or £180,000 per year in rent they'd otherwise be paying to other landlords. A simple calculation said you could spend £1.5m to transform all of these spaces into guest rooms, valued at around £500,000 each, and still have enough change to pay for off-site staff accommodation for 75 years and never once dip into your operating cash flow. Some 20 years later and those same rooms are now worth around £30m. Your treasure hunt is not just revenue-driven, you may also spot opportunities to

replace old equipment, windows and so on to improve energy efficiency; there are many ways to improve the bottom line.

## Revenue Management

Then there's revenue management. It is so important that large specialist asset management firms have started employing revenue asset managers specifically to ensure it is conducted well. What is it? Simply put, if you've ever booked a car rental, you might have noticed they charge you less depending on how far in advance you book. The rental firms got that idea from the airline industry, where it was first invented as yield management. Since then hotels and all manner of businesses have got in on the act. The theory is that people who book further out do so because they are more limited by budget, while people who book at the last minute have a definite need or desire and budget to pay full whack. This flew in the face of conventional wisdom that said a hotel room was 24-hour perishable – if you still had inventory at 11pm on a Tuesday night, you'd lose that day's revenue opportunity if you didn't sell it, so hotels offered discounts.

The whole revenue management system is complicated (there's a surprise) and best handled by specialists, but it does no harm to have a limited understanding:

The revenue manager decides what the absolute lowest price should be and what they think is the most they could get away with. They then divide all the prices in between, into around 10 brackets, known as Best Available Rate or BAR rates, which are commitments to the OTAs that they are just that – the best available rate for that room type on that day. Since this practice was introduced, this has now become best available online rate because the hotel is not restricted to these rates if someone phones in to make a booking (unlike online bookings). After they have established this framework, they look at the calendar and historic sales data and allocate a BAR to each day (and for each room type) for 6–18 months into the future. They also look around at the competition and see what rates they're publishing over the same period. Sophisticated, automated revenue management systems will then adjust the BARs depending on what is happening in the market – if there is a sudden spike in demand, they push the BAR up into the next category, and then the next and the next and so on as demand builds. These systems are pretty good and are improving all the time, but they need to be supervised to make sure they don't accidentally price gouge the public when there is a crisis behind the increase in demand.

Revenue managers look at total revenue, not just rooms revenue and weigh the value of a guest in terms of their likely spend throughout their stay when setting the BARs. The other thing to mention is that they deploy a much under-utilised calculation when setting the lowest BAR, the *break-even*. I was never shown break-even when I was at college and I suspect a lot of people still aren't, but it is almost the single most useful calculation you can do. Essentially, it is:

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Fixed costs less the contribution margin (which is sales price per unit sold, less variable cost per unit).

$$\frac{\text{Fixed Costs}}{\text{sales price per unit} - \text{variable cost per unit}}$$

Alternatively, you can go on:

$$BE = \frac{\text{Fixed Costs}}{\text{Gross Profit Margin}}$$

The most easily deployed usage is this last one: take your all costs that don't really change from month to month (your undistributed salaries and the cost of the staff hours you need to have at bare minimum to open for the hours you do, plus the bulk of your HLP costs, and so on). Determine what period you want to analyse (a day, a week, month or year) and divide the figure by that amount. Then calculate your variable cost percentage i.e. how much (%) of each \$ of revenue goes on cost of sales items, direct expenses and the balance of your departmental salaries (those not already included above). Divide your fixed costs by 1 minus your variable cost percentage to give you an amount. The figure that comes out is your revenue break-even; if you take less than that in the period, you're losing money. You can then divide your break-even amount by the typical number of guests for the period and it will tell you what their average spend needs to be (per stay, including revenue from other departments). Similarly, you can divide the break-even figure by the average spend and it will tell you how many guests you need to see. Please get familiar with this and get into the habit of checking it from time to time to see where you're at.

## Facilities Management

Keep a register of all of your maintenance contracts, certification renewal dates, expiry dates for things like fire extinguishers etc. and make sure you don't miss any. Then do regular health and safety audits and risk assessments – look at the accidents book to see if there is a particular area or activity that is causing repeated injuries and review it with an eye for improvement. Similarly, check the breakages and compliments book – see if you're having to give away freebies to guests or writing off damaged stock because of the same recurring fault or failure.

## Reporting

The general manager should always know their numbers and should be reporting to you the headlines weekly. You should then schedule a monthly review of both the financials, operating issues, upcoming significant events and the sales and

marketing activity for the period. Is it all on plan? If not why not? Is it systemic problem or a one-off? I once worked with a hotel where they got each department head to write a micro-business plan for their area, with details of target revenue (or rooms cleaned etc. in non-revenue areas), as well as what the competition was achieving (for housekeeping they looked at which competitors they were likely to lose staff to). Each one included a short SWOT and was a great tool to get everyone to focus on the objectives of the wider businesses in the context of their department i.e. incentivising people on what they can affect. Don't forget you are balancing short-term objectives with enhancing the asset value over the long term.

Data can help you with this and the key metrics to watch include:

1. ARR
2. Average Spend per room sold
3. GOPPAR (GOP per available room)
4. GP % (Gross Profit percentage)
5. Guest Acquisition Cost (your marketing spend divided by the number of guests you attract)
6. Life Time Guest Value (your regulars – how much have they spent? Target them for repeat stays)
7. Occupancy
8. Payroll %
9. Revenue per cover
10. Revenue per cover hour
11. RevPAM (per available metre)
12. RevPAR (revenue per available room)
13. Staff Turnover Rate
14. Table turns peer service
15. TREVPAR (Total Revenue per available room)

You should also consider intangibles like:

- Brand and Reputation
- Customer Data (protection and using it to enhance experiences)
- Risk Management

# Chapter 10

## EXIT? The Endless Project

Life's a Journey Not a Destination

So you should have had a plan for what happens when you want to retire, move on to a new venture, or sell, or whatever it was you planned to do. What was the trigger point you set for this? Did you hit it? There are, of course, several ways you can exit, but you also need to have set things up right in the beginning if all of the options are to be available to you. Exit routes include: sale, merger or acquisition, maybe even an IPO if things have gone really well. You might want to offer the chance to your management team to buy you out. Don't forget you don't necessarily have to exit, you can step back from the business or reduce your involvement – you'll just need a really good team that you trust to take up the slack. That's legacy planning and takes a long time to bed in.

If you are determined to exit, start early and plan it – give yourself at least a year if you can – it will take that time to prepare it for sale (I won't talk about the techniques for that now, as the ethics of these can be complex and locally nuanced; you want to realise as much value as you can, but you shouldn't deceive or misrepresent). Get an independent valuation, not the optimistic wet finger approach. Your valuer will probably be able to help advise you generally on the sale too, but you will most likely want to get specialist help with things like tax planning. Communicate openly with your team, there is nothing worse than them finding out you haven't been upfront about your plans (and yes, they will find out).

## Conclusions

Before we wrap up, I would like to tell you about something I've read about recently – *bungalow legs*. Bungalow legs is what can happen when someone retires and they move into a single-level house. They've earned it and it might well be the only available house where they wanted it. However, the lack of stairs and more importantly the lack of daily steps up and down them, can reduce our core strength and muscle in the lower body. These are key predictors of loss of balance and falls, which in turn reduces life expectancy.

Additionally, it has been discovered that in the Blue Zones around the world (where people live inordinately long lives), it is not diet that makes the difference, but isolation – the zones are communities who act together as communities. They meet daily, engage in social, community-led activities and this togetherness reduces stress and increases happiness, which are both determinants of longevity.

So, when you think about retiring, maybe have another thought and consider handing over stressful management to your trusted team and return to the 'shop-floor'; for example, taking on a job in frontline hospitality, ideally in a role that allows you to do what you've become great at – engaging with the customers. It might not save your life, but it might make the last few decades more rewarding.



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