Global hospitality insights

Top 10 thoughts for 2017

Building a better working world

Contents

Foreword

The hospitality industry continues to play an integral and robust role in the global economy. In 2016, key themes in the sector included innovation, globalization, technology and consolidation. Cross-border investment, large-scale mergers and acquisitions, and technology, such as data analytics, have changed the global landscape for hospitality executives.

While investors and developers remain active globally, market participants enter 2017 with a more cautious outlook relative to the prior year. The growth observed in most global markets has begun to decelerate amid new supply and high asset pricing. And the less certain outlook within the global economy has prompted market participants to re-examine their business strategies in the year ahead.

Yet uncertainty does not inhibit opportunity. Advancement exists for market players that adapt new and improved technologies to make more informed investment decisions and offer services that align with changing consumer preferences. By embracing change and innovation rather than resisting it, industry participants will position themselves to find growth and new possibilities in disruption.

In this year's *Global hospitality insights: top 10 thoughts for 2017* report, we reflect on 2016's global trends and seek to answer questions to help you build a better tomorrow in 2017, such as:

- How can you reduce the chance of cybersecurity breaches, but also understand the steps to resolve one?
- Following a merger, how can you prepare for a long life together?
- Is the future of your finance function robotic?
- Can asset monitoring unlock your asset value in times of uncertainty and change?

It is our pleasure to present *Global hospitality insights: top 10 thoughts for 2017*.

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1

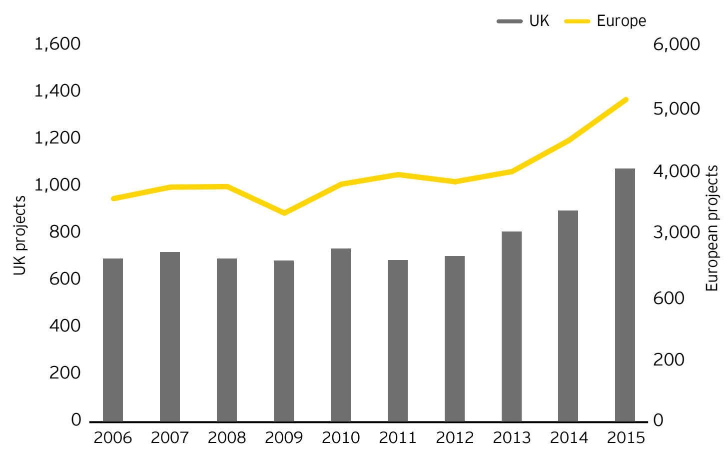
In Brexit's wake: hospitality and leisure update

As the UK prepares to leave the EU, will the hospitality community adapt to change or help to propel it?

In June 2016, the UK made a historic decision to leave the European Union (EU). While the ultimate decision to exit rests with the invocation of Article 50 of the Treaty of Lisbon, which sets out the processes and deadlines that govern a country leaving the EU, the window in which to lobby the UK government around new trade, tax and immigration policies post-Brexit is shortening rapidly. The UK has announced plans to leave within two years of the government's serving notice, which it has indicated will be before the end of March 2017. Assuming the UK does exit the EU, timing and planning are critical considerations for hospitality executives.

Although Brexit has shifted global investor perspectives and created an uncertain outlook around investment in the UK, there are still many positive signs. The UK has a strong and proven track record of securing foreign direct investment (FDI), with a steady increase since 2013 (see Figure 1). This is in part because at 20%, the UK has one of the lowest corporate tax rates in the world, and it is set to be reduced to 17% in 2020. For this reason, strong FDI looks set to continue. In addition, the EY 2016 UK attractiveness survey (see Figure 2) indicates that the UK remains a favorable location for FDI activities.[1] From a hospitality and leisure sector perspective, the UK remains one of the most visited countries in the world, with London ranking as the second-most visited tourist destination globally.[2]

Figure 1: Total number of FDI projects over the last 10 years — Europe and the UK

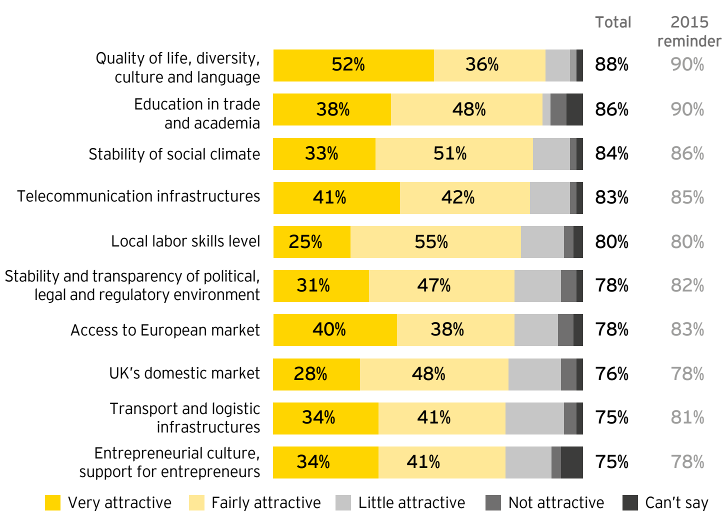


Source: *EY Global Investment Monitor 2016 and EY UK attractiveness survey 2016*

Nevertheless, Brexit will add further complexity to both the short- and medium-term outlook for the hospitality and leisure sector. The consumer confidence outlook, which is critical to the economy, appears challenging. Currency depreciation is pushing up inflation, which when combined with the low wage growth of recent years is forecast to squeeze real household incomes.

1. *EY's attractiveness survey – UK 2016,* EY, 2016. http://www.ey.com/Publication/vwLUAssets/2016-UK-Attractiveness-Survey/$FILE/EY-UK-Attractiveness-Survey-2016.pdf.
2. "Most visited cities: Euromonitor 2016," March 2016, accessed 7 December 2016 via CNN. http://www.cnn.com/2016/01/28/travel/most-visited-cities-euromonitor-2016/.

Figure 2: How attractive are different aspects of the UK as a location for establishing new FDI activities?

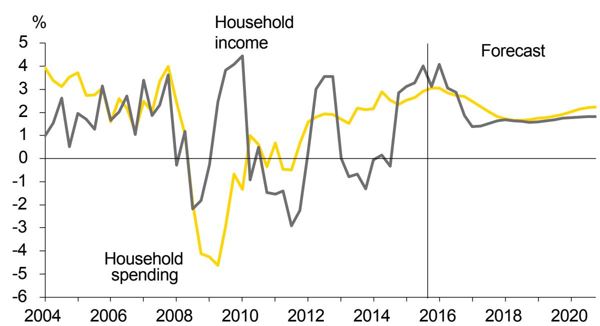


Source: *EY's UK attractiveness survey 2016*, sample (n=444)

This scenario will cause households to reassess both their consumption and saving plans, with a likely reduction in discretionary spending. An economically sensitive hospitality and leisure sector is likely to be at the forefront of any adjustment to consumer spending. While the devalued pound may help mitigate the impact on hotels in tourist-focused areas, this is far from a universal picture.

Amid the uncertain outlook, future increases in the government-mandated National Living Wage (NLW), a government minimum wage increase that took effect in April 2016, will also continue to pressure margins in the UK hospitality and leisure industry. The implementation of the NLW has forced operators to reassess other operating costs to mitigate the impact. The scope for further cost savings is likely to become increasingly challenging if cost inflation takes hold, resulting in further pressure on margins.

Figure 3: UK: real household income and spending



Source: EY ITEM Club

The sector will also be watching closely for any Brexit-induced adjustment to the UK's immigration policy. Migrant, lower-income labor has provided the sector with a strategic advantage, aided by new countries joining the EU. Migration from EU member states into the UK was a key reason for the Brexit referendum campaign, and the government's approach to this issue will be crucial for the sector. Transitioning from a migrant to a domestic labor force within the hospitality and leisure sector will require considerable investment from the industry and government in skills and education, as well as the movement of people toward industry employment hotspots.

The lead-up to the early 2017 official notice of Brexit is a critical, short period where action is necessary. For the hospitality and leisure sector, the process of helping to reshape UK legislation during this time provides an opportunity to advocate for the industry agenda and remove barriers to commerce, including examining the UK tax climate, which will help to maintain the UK as an attractive destination for investment.

2

The evolution of analytics in the global hospitality industry

Will digital help us do less or be more?

Data analytics is transforming how leading hospitality companies do business as they are increasingly using larger amounts of data and more advanced analytic techniques to make better decisions across functions. In this dynamic evolution, analytic tools are being used to measure and improve business performance, with a focus on the areas of revenue growth, customer relationship management and the guest experience. Analytics is also transforming the way hospitality companies approach transactions, including supporting the creation of a market outlook, assisting with target identification and enhancing the approach to evaluating a transaction.

Analytics in hotel management

The use of analytics often has a direct impact on revenue for hotel management companies. In the revenue management department, companies can now leverage data from a multitude of sources, including online search behavior, air traffic, competitor sales and future reservations to better forecast demand and optimize pricing. For example, RCI, a leading US timeshare broker, developed an analytics system for a timeshare exchange valuation that generated US$11.0m in revenue in the first year.[3] In the marketing department, hoteliers are developing a more granular understanding of guest behavior and expectations to identify customer segments and their buying preferences. With predictive models, they are now able to reveal guests' likelihood to respond to promotions.

Analytics also significantly improves the overall guest experience. For instance, booking app developers are able to improve the user interface and the algorithms behind the booking procedure by understanding the customer journey. This allows them to provide a personalized user experience and custom-made recommendations.[4] In addition, Ritz-Carlton's customer relationship management system, Mystique, incorporates analytics to understand individual customers' behavior and to create a customized guest experience during subsequent visits.[5]

3. Kelly A. McGuire, "The Analytic Hospitality Executive: Implementing Data Analytics in Hotels," 2016.
4. David C. Edelman, "Competing on Customer Journeys," *Harvard Business Review*, November 2015.
5. Micah Solomon, "Technology Invades Hospitality Industry: Hilton Robot, Domino Delivery Droid, Ritz-Carlton Mystique," *Forbes*, March 2016 (accessed via http://onforb.es/259BhLg, 30 November 2016).

Transaction analytics

Though the significance of data has always been evident in the M&A process, the use of big data and advanced analytics provides a deeper insight at a much finer level. For example, companies can now mine millions of lines of sales data, providing greater insight into customer activities, product groups and distribution channel performance. This level of analysis, typically performed through data mining and machine learning, enables an acquirer to gain a richer sense of the target's competitive position and a better understanding of its customer, financial and operational trends. It also helps a company better position itself to potential acquirers by providing evidence of the value of its assets and financial strength.

Social media is yet another area considered in transaction analytics. Social media analytics tools are used as a pre-acquisition "diagnostic" to provide the investors with an "outside-in" point of view on customer sentiment of the target and its competitors, including customer opinions, reactions to product launches, marketing effectiveness and brand affinity. They also support transaction pricing considerations. Visualization tools, such as Tableau and Spotfire, are commonly used to help dealmakers to see and understand big data, enabling multifaceted views of data that explore every dimension.

As the hospitality industry captures enormous volumes of diverse data sets, the effective use of analytics is dramatically changing how hospitality businesses are run.[6] Embracing data analytics will not only enhance the guest experience, but also drive top- and bottom-line results for hotel owners and management companies. In addition, those dealmakers who leverage data analytics in their diligence are likely to benefit from enhanced returns.

6. Goran Dragosavac, "Big Data Analytics in Hotel Industry," September 2015, accessed via http://www.kdnuggets.com/2015/09/big-data-analytics-hotel-industry.html, 30 October 2016.

3

Record Chinese investment in global lodging markets

Chinese investors' appetite has grown, but what will they be hungry for?

There was a significant increase in Chinese outbound investment, particularly into North America, Europe and other global lodging markets, reaching a record of US$9.4b for the 11 months ended November 2016. Transaction activity nearly doubled the US$4.9b invested from the same time period in 2015.[7] This also represents a nearly forty-fold increase from the US$240.5m in deals completed in 2011 through November, for a five-year compound annual growth rate (CAGR) of 108.1%.[8] Led by China's insurance companies, China's outbound investments are expected to set another record in 2017.

Reasons for investment

Chinese investors increased their overseas activity in 2016 due to the limited performance in domestic hospitality markets and the higher property yields and stable investment environments abroad. For certain companies, such as HNA Group, these investments have a synergetic benefit of supporting their other tourism-related businesses, such as travel agencies and airlines. Furthermore, the deregulation in China's insurance industry has allowed insurers a greater opportunity to invest in overseas real estate. In 2015, overseas investment accounted for just 1.9% of insurers' total assets, according to the China Insurance Regulatory Commission, but the overseas investment ceiling for Chinese insurers (set in 2012) is 15.0% of total assets.[9]

By investing abroad, investors are able to hedge against China's continuing currency devaluation. As of November 2016, China's yuan has devalued 5.7% relative to the US dollar.[10] And since devaluation began in August 2015, the yuan has devalued 10.0%.[11] Anticipating further devaluation, investors are expected to continue buying overseas properties. Although the Chinese central government is adopting measures to limit the flow of capital leaving its borders, it's unclear what the potential impact will be. In November 2016, the Chinese government announced plans to scrutinize outbound investments for deals exceeding US$1.0b if those deals are outside the investor's core business. In addition, state-owned enterprises may

7. Cross-Border Capital Tracker, November 2016, Real Capital Analytics, accessed 1 December 2016.
8. Cross-Border Capital Tracker, October 2016, Real Capital Analytics, accessed 1 December 2016.

9. "Insurance Companies Get Go-Ahead to Buy Hong Kong Shares in Stock Link Plan," CaixinOnline, 9 September 2016, http://english.caixin.com/2016-09-09/100987062.html, accessed 1 November 2016.
10. "USDCNY Spot Exchange Rate," Bloomberg, 30 November 2016, https://www.bloomberg.com/quote/USDCNY:CUR, accessed 1 December 2016.
11. "China's Yuan Move Could Reignite Asian Currency Wars," Bloomberg, 11 August 2015, https://www.bloomberg.com/news/articles/2015-08-11/china-s-devaluation-shock-seen-reigniting-currency-wars-in-asia, accessed 5 November 2016.

be prohibited from investing more than US$1.0b in a single foreign real estate transaction.[12]

Focus of investment

Abroad, Chinese investors in 2016 focused on entity-level transactions and joint ventures as a way to maximize scale and build brand recognition. In addition, there was also a focus on high-profile portfolio-level investments this year. A few examples of recent transactions in 2016 include:

- Anbang Insurance Group's US$5.5b acquisition of Strategic Hotels & Resorts, which included 15 of its 16 luxury US hotels, in September 2016.[13]
- China Life Insurance in 2016 formed a joint venture with sovereign-wealth funds to acquire a US$2.0b portfolio of 280 US limited-service hotels from Starwood Capital Group.[14]
- Cindat Capital Management closed a US$571.4m joint venture with Hersha Hospitality Trust in May 2016 for seven Manhattan hotels.[15]
- HNA Group announced plans to acquire approximately 25.0% of Hilton Worldwide Holdings. This was in addition to its acquisition of Carlson Hotel Inc. (including its majority interest in Rezidor Hotel Group AB) in April 2016.[16]

Gateway markets

Consistent with recent years, Chinese investors mainly invested in gateway markets in 2016, such as Manhattan, London, San Francisco and Chicago. Through the first 11 months of 2016, these four lodging markets accounted for approximately US$3.6b of investment, or approximately 38.2% of Chinese outbound lodging investment. Manhattan remained the top transaction market (with US$1.4b invested), while San Francisco and Chicago attracted US$1.2b and US$1.0b, respectively. In London, Chinese investment demand for the city's commercial property increased due to the Brexit-driven depreciation of Britain's sterling. For instance, in September 2016, HIG Capital sold the London Doubletree by Hilton to Junson Capital.[17]

Outlook

Lacking investment opportunities at home and desiring to build global brand recognition for their hotel assets, Chinese investors are likely to invest more in global hotel markets in 2017. A growing appetite for scale should continue to drive major players toward platform-level investments, particularly in major gateway markets. With Brexit presenting new opportunities and insurance regulations allowing Chinese insurers to allocate substantially more capital overseas, Chinese investors are expected to remain active cross-border hotel investors.

12. "China to clamp down on outbound M&A in war on capital flight," *Financial Times,* 29 November 2016, https://www.ft.com/content/2511fa56-b5f8-11e6-ba85-95d1533d9a62, accessed 16 December 2016.
13. "The 5 Biggest Chinese Investments In The U.S. In 2016," *Forbes*, 21 December 2016, http://www.forbes.com/sites/ellensheng/2016/12/21/5-biggest-chinese-investments-in-us-2016/2/#20788c742737.
14. "China Life Invests in US$2b of Starwood Capital Hotels," Bloomberg, 18 October 2016, http://www.bloomberg.com/news/articles/2016-10-18/china-life-invests-in-2-billion-of-starwood-capital-u-s-hotels, accessed 1 November 2016.
15. "Hersha Hospitality Trust Closes Manhattan 7-Hotel Joint-Venture with Cindat," *Business Wire,* 2 May 2016.
16. "Blackstone's Search for Real Estate Buyers Keeps Ending in China," Bloomberg, 24 October 2016, http://www.bloomberg.com/news/articles/2016-10-24/hna-group-to-buy-25-percent-of-hilton-worldwide-from-blackstone, accessed 1 November 2016.

17. "Docklands Doubletree by Hilton Hotel Sells to Chinese Investors," CBRE, 8 September 2016, http://www.cbrehotels.com/EN/PressCentre/Pages/Docklands-Doubletree-by-Hilton-Hotel-sells-to-Chinese-investors.aspx.

4

Real estate and hospitality disrupters

In a rapidly changing world, what will disrupt the disrupters?

Technology + demographics + globalization

Today, the interlocking forces of technology, demographics and globalization are disrupting organizations of all types across all industries. The real estate industry, and the hospitality sector specifically, is no exception.

The transformation of real estate

What's important to keep in mind is that while disruption threatens traditional business models and value chains, there are also significant opportunities in the changes taking place.

Technology continues to have a tremendous impact on hospitality and the broader real estate sector. E-commerce has slowed in-store shopping, resulting in retail store closures. At the same time, new technologies such as virtual reality could transform physical stores into experiential showrooms, highlighting the continued need for retail real estate. The expansion of online shopping implies the need for more and more local distribution and warehouse facilities. Similarly, expected labor force displacement by robots will have a huge impact on the number and scale of needed manufacturing facilities, as well as the traditional staffing model.

The digitally enabled sharing economy provides an example of sector disruption. Digital platform company Airbnb entered the hospitality industry without owning any hotels, becoming a new competitive force and causing traditional lodging companies to re-examine their business models and physical footprints. Going forward, the value of hospitality companies increasingly resides in digital innovation.

Other commercial real estate sectors have challenged traditional business in the wake of new customer demands. The opportunity for hospitality also exists in not resisting technological changes, but in creatively adapting and capitalizing on them to improve outdated business practices and expand market share.

Demographic shifts and preferences, coupled with technological advances, will also affect hospitality and the broader commercial real estate sector. Many societies, particularly in the West but also in Japan and China, face rapidly aging populations. As people age, their real estate preferences and needs change. In some markets, aging populations will spur the growth of lifestyle-focused communities and real estate offerings, along with new forms of urban design. Real estate investment patterns are changing as pension funds and other wealth management vehicles seek asset classes with secure income streams to see older people through their retirements.

Preferences for flexibility on the part of younger workers, enabled by technology to work anytime and anywhere, are already putting strain on class B and C office space as corporations reduce their real estate footprints, particularly with non-headquarters locations. Corporations are also exploring new office sharing models. At the same time, we see companies relocating their workforces from suburban locations back into class A buildings in urban centers in order to attract premier talent. The influence of demographics on office trends presents new opportunities for the lodging sector, as developers and brands seek to remain ahead of the curve in catering to both established and emerging generations of corporate employees and travelers.

With globalization, capital for real estate has increasingly made its way across borders, reaching record levels in recent years. This phenomenon has shifted the hospitality landscape, as international players, including investors, operators and brands, diversify their hotel portfolios abroad. One of the longer-term effects of globalization has been rapid urbanization. The expectation that population growth will see US$2.5b urban people added to the planet between 2015 and 2050, with 90% of that growth happening in Asia and Africa, suggests massive construction demand in these parts of the world over the next several decades. At the same time, climate change and other forces create opportunities for new types of construction that are smart, green and resilient.

The unique challenges of real estate

All industries face disruptive forces. The unique dynamics of real estate make the challenge of disruption particularly steep. The planning, delivery and management of real property requires a long-term vision, which is difficult to establish in a rapidly changing world. In the hospitality sector, leaders must try to better anticipate the future and consciously adopt new ideas, with success depending on the ability to proactively shape and drive future demand. With all of these changes, hotel players clearly need to think differently, assessing both the weak and strong signals in the market that spell change, as well as making bets on future opportunities. As the world continues to evolve — driven by the forces of technology, demographics and globalization — business as usual is not an option.

5

Cybersecurity: preparing and responding to a breach

In a future where data is everywhere, who will keep it out of the wrong hands?

With data breaches on the rise, cybersecurity remains a top-of-mind issue for hospitality executives globally. Despite preventive measures, hotel companies including the industry's largest players are still susceptible to security hacks. With an attack potentially costing millions of dollars, and with customer relationship management and brand reputation more important to hospitality companies than ever, they must not only try to prevent cybersecurity breaches but, in the event of an attack, be prepared to quickly resolve them.

Confronting a security breach requires seamless integration of people, processes and tools. As hospitality companies gather facts and their unfolding investigation reveals more information, their initial conclusions about a cyber attack, such as what was accessed or stolen, may prove wrong. Immediately after a data breach, they must quickly address the following critical questions, which can help them correctly diagnose the problem:

- When and how did the adversary first gain access into my system?
- Is the attacker still active? If so, how can the breach be contained and eliminated?
- Which data did the hacker access or take?
- For any data accessed or stolen, are breach notification requirements triggered, such as personally identifiable information, protected health information or credit card information?
- Has the hacker deployed any tools that could impact the integrity of our company's data or ability to access that data later?
- Has the hacker inserted back doors in our system so that he or she can return at a later time?

To answer these questions, hospitality companies should adapt the following leading practices in preparing for and responding to a security incident.

- **Know how to escalate:** Many large breaches occur because a company did not escalate to IT management seemingly routine issues such as malware, suspicious connections to external IP addresses and intrusion detection alerts. A company's IT help desk, which oversees security as well as more general IT issues, normally decides whether to escalate. IT desks are usually skilled at addressing IT problems such as those related to connectivity and application troubleshooting; however, they often fail to escalate reports of everyday security issues that they perceive as low risk. To address this problem, a company should use a tracking system to evaluate routine incidents and flag repeated, small-scale breaches. Industry-leading tracking systems not only detect potential threats, such as malware, but assess whether the company has mitigated the threat.
- **Have general counsel lead the investigation:** When a computer security incident such as stolen data or data destruction occurs, hotel corporations often face not only technical issues but also larger legal and regulatory challenges. A company's general counsel should direct the investigation to confirm that it properly manages legal issues, including possible regulatory inquiries and civil litigation.
- **Create two teams to provide the response:** Another leading practice is for the company to have two distinct teams in place to help it recover from an attack. One is an investigative team that focuses on the root cause of the cyber breach. The other is a team that concentrates on fixing the problem. The segregation of duties between teams improves the response time following a cyber hack.

The average security breach costs hotel companies an estimated US$4.0m,[18] and such breaches remain a serious threat to the global hospitality sector. Companies must be prepared to quickly detect an attack, correctly diagnose the causes and mitigate financial and reputational damage.

18. "Cyber insurance is indispensable to hospitality risk management," *Hotel Management Magazine,* 19 July 2016, accessed 29 November 2016, http://www.hotelmanagement.net/tech/cyber-insurance-indispensible-to-hospitality-risk-management.

6

Robotic process automation: advancements in technology

Is the future of the finance function robotic?

To effectively manage business today, hotel professionals must equip their finance team with the right tools to meet key challenges. One such tool that has emerged, and hotels are now adapting, is the use of robotic process automation (RPA). With RPA, employees configure advanced software or a "robot" (also known as a bot), which automatically performs routine business processes. Among other benefits, RPA helps hotel companies operate more quickly and efficiently, reduce the risk of errors in processing information and reduce labor costs.

RPA is an off-the-shelf technology that businesses can acquire from select vendors and set up for their own particular needs. As a "virtual employee," a bot accesses and manipulates other computer applications through their user interfaces, which enables it to automate high-volume, repetitive tasks. RPA is not designed to replace a company's IT systems, but rather to enhance them — for instance, by better integrating systems and eliminating silos that can interrupt or impede processes. Unlike prior automation software, new advances in RPA technology enable the software to adapt to changing situations, allowing bots to initiate new actions and communicate with data systems automatically.

RPA generally does not require significant programming skills and is not difficult to learn and use. Employees can be trained to assign bots to complete tasks and initiate processes, as well as monitor and manage operations. In contrast to installations or upgrades of traditional IT systems, which can be costly and time-consuming, RPA is a relatively low-cost technology, and companies can often recover their investment in a short period of time.

RPA can be used across a wide range of hotel functions. For instance, it can be used in customer services such as reservations, check-in and room service, but also in a variety of other operations. A few examples include:

- **Procurement:** compare a company's purchase orders with invoices from vendors
- **Vendor payments:** create accounts for new vendors and fill in forms with vendor information
- **Accounting:** data entry and processing for quarterly closing procedures
- **Payroll:** collect data from files or systems, and copy and check data for completeness
- **Human resources:** onboard new hires by sending them information and access to key employee resources
- **Administration of learning development:** alert employees when their certifications, such as CPA, are about to expire and confirm that they have renewed certifications

In processing information, RPA can detect and alert employees of errors that could disrupt the flow of information in a company, create delays and add to processing costs. Assume, for instance, that an employee punches out for lunch but forgets to punch back in. It was a simple oversight, but it could confuse a traditional time management system that is programmed to record an employee's checking in twice a day and checking out twice a day. RPA would alert a manager about the error.

Outlook

Given the many benefits of RPA, adoption is expected by more hotel companies. In doing so, companies should bear in mind that while RPA could possibly eliminate some jobs where the tasks performed are routine, they will need to retain the key people who are experienced in running accounting, HR and other operations so they can apply that experience in managing RPA; they may also need to hire employees to assist with RPA management. In addition, RPA training will be important in order to take full advantage its value as future upgrades are frequently released on the major RPA platforms.

In sum, RPA offers companies the opportunity to make their business processes more efficient, reliable and cost-effective. But to take full advantage of that opportunity, they must clearly understand how to plan for and adopt the technology.

7

Sharing economy 2.0: the next chapter

Will you wait for disrupters to shape the future or take a hand in shaping it?

Sharing economy, or peer-to-peer, lodging platforms will continue to shape the global hospitality industry for leisure and business travelers and hotel stakeholders. For example, in 2016, the number of listings at Airbnb, a major peer-to-peer platform, exceeded 2.0 million globally.[19]

The impact of these platforms on traditional hotels is becoming better understood and more easily measured. Given that, owners, developers and operators should assess current and future projects within the context of peer-to-peer offerings, which continue to mature and grow in major travel destinations.

Key insights about the new platforms have been revealing. A recent analysis by Smith Travel Research found that traditional hotels and peer-to-peer lodging platforms tend to experience similar seasonality, with higher occupancy during periods of peak leisure travel. In addition, markets with the highest peer-to-peer occupancy tend to be in strong traditional hotel markets. Finally, the impact of peer-to-peer inventory on the number of hotel compression nights — high demand nights during which traditional hotels can more easily achieve rate premiums — may be more limited than previously thought.[20]

In 2016, increasing government involvement subjected peer-to-peer players to new taxes and regulations similar to those imposed on traditional hotels. These included building accessibility and safety rules, transient occupancy taxes and headline-making length-of-stay regulations. For example, New York City no longer permits short-term rentals (if the host is not present), and London and Amsterdam now restrict the number of nights per year a private home may be rented.[21]

19. "About Us," Airbnb website, https://www.airbnb.com/about/about-us, accessed 3 January 2017.

20. "New Airbnb data sheds light on 13 global markets," Hotel News Now website,http://hotelnewsnow.com/Articles/77191/New-Airbnb-data-sheds-light-on-13-global-markets, 11 October 2016, accessed 8 December 2016.

21. "Airbnb Won't Pursue Legal Case Against New York City Over Rental Law," *The Wall Street Journal*, http://www.wsj.com/articles/airbnb-wont-pursue-legal-case-against-newyork-city-over-rental-law-1480738473, 2 December 2016, accessed 8 December 2016.

To continue to grow in an increasingly competitive and more regulated lodging market, peer-to-peer lodging platforms are exploring opportunities to diversify. For example, some peer-to-peer platforms could transform into an alternative distribution channel for traditional hotel inventory. This would allow lodging operators to both reach new customers through the peer-to-peer platform and reduce distribution costs associated with online travel agencies.[22] Peer-to-peer concepts are also gaining traction in the corporate travel community. One such platform recently launched a corporate travel portal and is collaborating with a major corporate travel management provider to offer rooms to business travelers.[23] In another development, Airbnb recently announced a new experiential platform that aims to connect users with experiences like cooking classes, workshops and tours.

In response to the growth in peer-to-peer lodging, traditional hotels are adopting different strategies to appeal to travelers attracted to the ease of online booking and the immersive travel experience offered by home rentals. For instance, some major hotel brands are enhancing technology offerings like mobile — such as booking, check-in, mobile keys, payment and in-room service — and social media platforms for guests. Other hotel companies are competing by playing to their traditional strengths, including adding or expanding concierge services or touting the benefits of their loyalty programs. One major hospitality company recently acquired an online concierge services provider to enhance the overall travel experience for its guests.[24]

Peer-to-peer platforms continue to evolve and expand their product offerings. Consequently, owners, developers and operators need to understand how this trend will impact the performance and value of their current and prospective hotel investments, and the changes they will need to make to compete. One thing is clear: ongoing innovation by peer-to-peer lodging players will continue to influence the entire industry's future.

22. "The Next Big Hotel Distribution Channel: Airbnb," LinkedIn website, https://www.linkedin.com/pulse/next-big-hotel-distribution-channel-airbnb-del-ross, 22 October 2015, accessed 8 December 2016.

23. "American Express Global Business Travel And Airbnb For Business Announce New Agreement For Business Travelers, American Express Global Business Travel website, https://www.amexglobalbusinesstravel.com/blog/airbnb-agreement-business-travelers/, 12 July 2016, accessed 8 December 2016.

24. "AccorHotels Acquires Majority Stake in Concierge and Loyalty Provider John Paul," Skift website, https://skift.com/2016/11/17/accorhotels-acquires-majority-stake-inconcierge-and-loyalty-provider-john-paul/, 17 November 2016, accessed 8 December 2016.

8

Post-merger integration: promoting long-term deal success

How can you prepare for a long life together?

Post-merger integration

Consolidation in the global hospitality industry is expected to continue, influenced by broader macro and industry-specific forces, including globalization, changing customer preferences, innovation and technology, and the sharing economy. In 2017, hotel companies will continue to pursue mergers and acquisitions that capitalize on the target company's value.

Whether a transaction succeeds depends largely on the acquiring company's ability to integrate the target company, with its different operating methods and distinct culture. Transactions most often fail because of poor integration, a recent EY survey found. In planning transactions, companies therefore must develop integration strategies, including identifying and adopting leading integration practices that can promote a deal's long-term success. Among other needs, integration will require the right resource model and tools.

Mitigating operational challenges with technology

Leading online software platforms provide companies with a toolset to manage risk and achieve value when executing a transaction. They enable companies to mitigate many of the most common transaction challenges, helping to bring about a successful integration. This kind of platform includes the following tools:

- **A pipeline model:** this captures and evaluates investment opportunities based on an organization's needs.
- **A business portfolio model:** this reviews the market performance of an organization's existing business portfolio to understand potential investment, reorganization and divestiture opportunities.
- **A diligence model:** this uses consistent and structured applications that enable internal and external teams to collaborate; share information on data requests, deal insights and red flags; and achieve clearly stated goals.
- **An integration and divestiture model:** this provides access to consistent information about all of a company's initiatives in real time.

No matter where the company is in the M&A cycle, cutting-edge technology and tools are critical for addressing issues such as miscommunication among team members that leaves them confused and frustrated. By automating the transaction process and using common templates, support teams (local or remote, executive management and advisors) can view real-time information, capture data, coordinate goals, collaborate online and create consistent reports.

Uniting around a common culture and purpose

In today's globally connected industry, a company's success with integration means uniting the two companies around a common culture and purpose for future growth. According to an EY study, companies that embody a common organizational culture and purpose are often more successful at engaging stakeholders and employees during and after the integration process.[25] Pre-integration, the distinct cultures of the acquiring and acquired companies may be very different. These include linguistic differences as well as differences in behavioral style, company vision, decision-making processes and cultural values. Company leadership therefore should be responsible for the following:

- **A culture assessment:** categorize and understand cultural values; compare leadership styles and analyze potential conflicts
- **Planning:** establish an internal culture transition team and support requirements, and create a culture transition timetable and plan
- **Communicate with employees:** provide transparency about key employee information through communication between senior- and mid-level managers of both companies and distribute/analyze an employee satisfaction survey
- **Create interim/transition policies:** generate interim management mechanisms
- **Culture training:** execute a culture transition plan, including composing transition communication materials, organizing transition activities and conducting transition promotion training

25. "Purpose-Led Transformation: Benefits & examples," EY, accessed 8 December 2016, http://www.ey.com/gl/en/services/advisory/ey-purpose-led-transformation-benefits-and-examples.

Determining integration success post-integration

To objectively evaluate the success of a transaction, companies should perform a look-back analysis to assess integration achievements and challenges experienced during the integration process.

A look-back analysis, typically completed between 18 to 24 months after integration, compares the combined company's proposed valuation presented to the board before the transaction with the combined company's valuation post-integration. It also interviews participants involved in the integration process to gather their insights. The analysis helps to answer the following questions:

- Did we meet our targets from a quantitative perspective?
- Did we follow leading practices from a process perspective?
- Where did we not follow leading practices? Did this lead to a shortfall?
- What lessons learned can we apply to improve our approach in the future?

Operational inefficiencies and unrealized synergies pose risks that could lead to increased operating costs. To assess the status of the combined company, each synergy should be analyzed to determine whether it was realized. Common mistakes include two teams counting the same synergy, confusing a one-time synergy with a recurring synergy and not fully determining the cost to capture a synergy, while counting the benefit.

In sum, as hospitality companies use leading tools to mitigate the impact of integration issues on a transaction, unite around a common culture and purpose, and drive continuous assessment and improvement, they will position the newly combined company for strong future growth.

9

Optimizing hotel asset value

Optimize for today? Build for tomorrow?

As the hospitality cycle enters its later stages and operating cost escalation continues to accelerate, the focus of investors and owners is shifting from investing in new opportunities to optimizing the performance of their existing assets. In addition, recent record levels of cross-border investment activity are creating a greater geographic diversity in investors' portfolios, exposing them to new markets in which they have less experience and on-the-ground presence to quickly adapt to uncertain market dynamics. As a result, having a proactive asset monitoring strategy is becoming more critical to preserve and strategically enhance value.

Greater economic uncertainty and steadily increasing supply, paired with weakening demand, is anticipated to continue to result in slowing top-line performance across many regions around the world in 2017. This continues a trend already seen in 2016. A majority of markets are starting to experience the negative impact from the influx of new hotel openings, coupled with slowing market fundamentals on operating performance, as 2017 RevPAR growth rates are expected to be near their lowest level since the start of the current cycle in 2010. Following a near-record year of transaction activity in the hotel sector in 2015, increasing uncertainty in the performance outlook has led to a slowdown in global hotel transactions in 2016, as investors shift their focus from new deals to maximizing the value of existing assets under ownership.[26]

Proactive asset monitoring is essential for owners to improve their competitive positioning and operational performance to optimize value. A prerequisite to effective and proactive asset monitoring is a thorough understanding of the asset's market environment. This becomes particularly challenging for cross-border investors with limited local resources in the new markets that they have invested in, as well as for nontraditional hotel investors with limited in-house experience in the hotel industry. For these investor groups, implementing a strategy to fill that knowledge and resource gap is a critical success factor. It allows them to execute their investment strategy, while also helping to fulfill fiduciary responsibilities by mitigating other potential market-related risks.

26. "Hotel Investment Outlook 2016" and "Hotel Investment Outlook 2015," JLL.

Proactive asset monitoring works closely with ownership, property management and the hotel brand company on an ongoing basis to holistically focus on different opportunities and challenges throughout an investment's life cycle. It includes performance oversight, aligning the interests among the different stakeholders, strategic planning, tax optimization strategies, internal controls, operational improvements, sourcing and monitoring strategic partnerships, optimizing working capital and evaluating strategic asset improvements, among others, that drive the asset's value. Asking the right questions helps you understand the effectiveness of your asset monitoring strategy. These questions include:

- How are you adapting your revenue management strategy to optimize top-line performance given the rapid changes in market dynamics, technology and influx of new supply?
- How are you managing rising labor costs to optimize the bottom line without sacrificing quality?
- How effectively are you using social media to manage your asset's individual brand and to proactively interact with your customers?
- Which capital expenditure investments offer the right return on investment to sustain and enhance your asset's positioning long term, particularly given the introduction of new competitive supply?
- How effectively do you manage working capital?
- Do you have the optimal partnerships (brand, management and marketing, etc.) that enhance your asset's value, and are they aligned with your strategic objectives?

The number of different stakeholders in hotel investments poses a critical challenge to effective asset monitoring. Key parties involved in hotel investments typically include ownership, operator and brand. During the current stage of the transaction life cycle, it is essential to have a proactive asset monitoring strategy in place that will not only help align interests among the different stakeholders but also optimize investors' portfolios.

10

Lodging as an anchor for vacation-home communities

What's the right recipe to accelerate growth?

The traditional country-club lifestyle and golf-anchored vacation-home resort community has given way to a new type of vacation community found around the globe that incorporates lodging as an important component.

Historically, master-planned vacation-home resorts were usually developed in destinations that had a critical mass of potential buyers and were marketed with focused sales efforts. These developments centered on a golf course and club membership lifestyle, with limited amenities outside golf, a restaurant, pool and tennis/racquetball courts. Often, they had no dedicated hotel. To differentiate themselves, some communities began incorporating small, unbranded hotels that provided room rental, with an optional front desk, for residents' family and friends. The hotel also served as a social venue, including being a location for weddings and other informal gatherings.

As golf has become less central for buyers, who instead desire more family-friendly experiences and amenities, the hotel has evolved into a larger, more prominent and defined part of the community. It not only provides lodging but also serves as a sales center that markets the community to residential buyers. And the hotels also afford the developer more flexibility, including the absence of branded facility requirements, as well as reduced up-front costs, such as franchise fees.

Today, the hotel concept is more often at the center of development planning for new, larger and more active resort lifestyle vacation-home communities. What's also changing is that developers are collaborating with internationally recognized hotel management companies to operate the larger and more traditional resort hotels in the communities. Such partnerships help to establish a resort's credibility, set expectations for its quality and positioning, and help guide long-term planning for future residential phases. In addition, they help win the confidence of residential home buyers, whose homes are now stamped with the hotel brand, another key change.

Branding the residential component with the hotel's brand provides several benefits to home buyers. First, they are afforded hotel services and amenities as if they were guests. In addition, because of the resort's brand reputation, their homes enjoy a higher value than comparable non-branded real estate products.[27] Furthermore, buyers can share a community with like-minded neighbors; generate potential rental income from renting their homes when not in use, partially offseting carrying costs; and realize higher resale values.[28]

27. "Branded Residences: What's in a Name?," Hotel News Resource, 4 October 2016, www.hotelnewsresource.com/article91402.html.
28. Graham, Chris, "Branded Residences: An Overview," February 2016, http://www.gagms.com/wp-content/uploads/2016/02/Branding_Report_FNL.pdf.

The developers benefit from the brand as well. When they release the residential component, the brand typically allows them to implement pricing premiums, and it also provides added marketing and sales exposure. In some parts of the world, such as the Caribbean and Latin America, global brands are essential to instilling buyer confidence in owning homes. In addition, once established, these communities can increase the performance of other non-branded elements, such as condominiums or villas in concurrent or future sales phases. Hotel operators, for their part, are able to expand their carefully curated brand both into the residential market and into global locations where stand-alone hotel development may not be feasible.

However, the concept of an internationally branded hotel-anchored project is not without its challenges. One challenge is the typically higher development costs of these hotels compared to other types of hotel development, namely due to the need to build more amenities and service a larger room inventory. While one typically expects the hotel brand and residential premiums to offset these costs, monitoring the amenities and inventory that are actually needed is critical to achieving desired returns.

Another challenge is that the developer's control over the overall experience is somewhat ceded to the hotel management company, which seeks to limit access to certain hotel amenities and services to buyers of the branded residences, while buyers of the unbranded residences are not provided access to the hotel component outside of typical public amenities, such as restaurants and a spa. Consequently, often a separate residents' club is needed apart from the hotel component.

A third challenge is that many hotel operators require owners of the branded residences to place their units in a hotel-managed rental program, eliminating the many choices today's buyers have in renting their homes through other third-party platforms. This has strained traditional models of administration and management as the hotel brands are often left to play detective to confirm that owners are appropriately using the required rental program, instead of renting the units on their own accord.

To succeed, developers must determine whether they can recover the added costs of a branded hotel in income from the residential component. They must have a thorough understanding of the benefits and weaknesses of incorporating a hotel development with a residential component and how the community's residential rental program should operate. Finally, they must balance the timing and phasing of residential components with the phase-in of the lodging and residential rental program operations.

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