Pandox—A Hotel Owner-Operator's Smorgasbord of Options

Summary

This case study discusses Pandox, a large Swedish hotel owner and operator. Pandox focuses on investing in hotel properties in Northern Europe, and leasing those out to lessee-operators. About one-fifth of the company's portfolio is operated by Pandox themselves, either as a franchise or independently – the company prides itself on having developed a number of what it calls 'independent brands' themselves. The 'odd one out' are two Canadian hotels that are managed on Pandox' behalf by a branded management company, and one Norwegian hotel that Pandox operates and leases from a third-party owner.[1]

Pandox' executive leadership is well-known within the industry for having quite outspoken opinions on several aspects of ownership, operations and branding. First and foremost: the lease as the preferred operating structure to create a partnership between owners and operators of hotel properties. This case presents this and other positions Pandox management have publicly espoused, and encourages students to use them as 'stepping stones' to explore and enhance their understanding of the structure of the hotel industry.

Teaching Objectives and Target Audience

Eringa and Jin (2013) assert that management case studies often fail to meet learning objectives, as they are generally written at a level that is beyond the understanding of the students, who have little or no real-world business / managerial experience. For a case like this one, which aims to teach (under)graduate hospitality students relatively abstract concepts of hotel ownership and operation, it is then especially essential to 'connect' as much as possible to the target audience. To bridge this gap, as Eringa and Jin recommend, the author has included a diverse set of sources, e.g. the Economist, an industry source such as the anonymous developer, and hospitality newsletters.

It is assumed students studying this case have been exposed to concepts such as franchises, management contracts and leases, but most likely only superficially so. This will usually have been in the context of introductory courses in Hospitality Management or Marketing, where the focus was on something else than an in-depth understanding of ownership configurations and owner-operator relationships. The recommended teaching approach described below has been used for such a group of students, and it allows the instructor to 'warm up' the group more or less prior to discussing the answers to the case questions. The case could also be used as a part of a concentration / elective course in for example hotel asset management. If that is the case, and students already have a more substantial understanding of the basic concepts in the case, the discussion questions could be addressed directly, and serve as the basis for a much more advanced discussion.

Recommended Teaching Approach and Strategy

Whatever the target group and educational context, students should be asked to read the case prior to the classroom session. They should also be encouraged to research the current state of affairs of the company. A good starting point for that would be the Pandox website, which has copies of annual reports and an overview of press releases.

The case instructor should start the classroom discussion asking students for their understanding of possible difficult terms in the text, such as for example the "passive investment model" in Mr. Nissen's quote.

In case this teaching case is used with students relatively new to the concepts discussed, the discussion may start with exploring to what extent they are familiar with the operating structure of individual hotels they all know, for example:

- some of the local hotels;
- hotels they did their internships in;
- certain 'flagship' hotels in the area, or the state/country's capital;
- or even properties that are known the world around (e.g. the take-over of the New York City Waldorf Astoria by Chinese Anbang, with Hilton obtaining a (100 year!) management contract, was widely publicized).

Discussion Questions

1. **How would you characterize the company in a nutshell? Who are Pandox' competitors, or similar hotel businesses? Discuss the rationale (advantages and disadvantages) of the company's strategy to use different ownership and operation models.**

   Firstly it should be noted there is a focus in the Pandox business model: the cornerstone of their strategy is (active) ownership of hotel properties (real estate). The majority of hotels are leased out, as dictated by their EPRA membership, and the company strives to achieve a partnership with the lessee-operator. That said, within these constraints, there is quite a bit of diversity: the company also operates a significant part of the hotels it owns; bought two hotels encumbered with a management agreement (hma); has both franchise agreements with different brands and developed a number of proprietary brands; and has, as of late, started operating a non-owned hotel. To put this question in perspective, the discussion could start from an exploration of various hotel companies students are familiar with. For example, Four Seasons, a pure-play luxury

1 The company's asset management services provided to the owners of 8 further hotels don't feature in this case, but instructors in more advanced courses could use this element of Pandox' business model to highlight the increasing importance of asset managers in the industry.

branded management company. Or one more similar to Pandox: Host Hotels and Resorts. This is the Real Estate Investment Trust created in 1993 by spinning off, from Marriott Corp, its management and franchising business, Marriott International, leaving what is now Host. This company, like Pandox, is a hotel owner, but one preferring management agreements to leases (see also discussion question 4 further down). Or AccorHotels, a much diversified hotel owner, lessee, manager and franchisor.

A big advantage of a more diverse business model is that it allows the company to act upon a diverse set of opportunities. One such opportunity could be hotel properties and/or operations coming up for sale, buying them and performing a 'turn-around'/repositioning. The idea of hotels being both a business (providing cash flow from operations) and a financial asset (that will ideally appreciate in value over the holding period) should be discussed here. Market issues could also be discussed: Pandox disposing of two portfolios of smaller Swedish hotels in non-key locations, and also taking over operations in others, show the company can change its profile in light of changing market situations. An interesting aspect of this is the limits imposed by the EPRA membership: when the company grows its Operating Activities portfolio (by taking over operations of their properties), the Property Management portfolio should grow commensurately, to maintain a minimum of 80 percent of revenue from real estate ownership.

Among any potential disadvantages of using more models is that it may create organizational complexities; that it may turn the company into a competitor of its major tenants like Scandic; or that the investment community prefers 'pure play' owners and operators, which would thus negatively impact Pandox' valuation. The latter is mostly a theoretical disadvantage only, as almost 80 percent of Pandox' A shares are owned by just three Swedish majority shareholders, that each have representatives on the Pandox Board of Directors.

2. **To what extent do you agree with the Director of International Operations' assertion that independent management companies are a better option for owners who want to outsource operations management than the large international chains?**

   Having a strong brand operate your hotel will have obvious advantages, but will also place brand standard demands on the owner. The latter might consider some of those demands as not appropriate for the property, or as unnecessarily expensive, in short: as not contributing to the profitability of the hotel. The same consideration of course also applies to an owner-operated franchise hotel, and in both cases owners should consider carefully what they expect from affiliation with a brand. But the main concern of the Director in question goes beyond that: he feels there may be an agency problem in that branded managers may put the brand interest and maximization of management fees above achieving a profitable operation. In contrast, in his opinion independent management companies may not only offer better contract terms, but may also be able to focus more on managing the hotel. The instructor could elicit student opinions based on their experiences in internships (provided they know the exact operating configuration).

3. **What do you think of Mr. Nissen's (2013:2) assessment of the hotel management agreement as an 'unfair' operating structure?**

   Management companies would deny any agency issues exist, in a management agreement. They will argue that the interests of owner and manager are aligned through the fee structure: the manager's reward (base and incentive fees) is related to the success of the hotel operation. They would also argue that if and when they manage the hotel successfully, the owner (and not the operator) would benefit from an appreciation of the value of the hotel, and could sell it at a profit. The instructor could ask students to compare variable leases to an hma with incentives. For example, what would be different from an hma when a lease would be structured in such a way that the rent payable to the owner would be all of the property's cash flow, minus a small percentage of revenue and a larger percentage of gross operating profit? In terms of legal and business risk, this would still be a lease, and ownership of the operation would sit with the operator, but in terms of cash flow distribution, this would be very much like an hma.

4. **Figure 2 represents the asset-heavy – asset-light continuum, from the point of view of a branded hotel operator. Discuss this continuum from the point of view of a company that is primarily a hotel owner.**

   This question serves as a check on students' comprehension of the operating structures and concepts, and also as a way to further enhance it. The discussion could be as follows. Starting from the left, owner-operated is still first, if the owner decides to operate their property themselves. Should they decide to flag the hotel using a franchise, the strategy would still be considered asset-heavy, but with some 'help' from the intangible asset that is the brand – at the expense of more limited control, as the owner now has to adhere to brand standards. Moving further to the right, if the owner decides NOT to operate themselves, lease and hma come into play. However, they will switch positions if taking the owner's point of view. As follows from the discussion question 3: in an hma, the owner still is relatively asset-heavy as they own the operation and run the associated business risks. If the owner decides to lease out, that risk is with the lessee-operator. An interesting 'compare and contrast' would be that between Pandox and HOST Hotels and Resorts (mentioned in discussion question 1). In contrast to Pandox, HOST works exclusively with management agreements, seeking the upside they potentially offer, at least compared to a fixed lease. The instructor could also ask the students whether they really consider a (fixed) lease to be low-risk for an owner. Illustrative would be to mention lessee-operators that had signed fixed leases and could not pay those anymore, which could also mean loss of rent revenue for the owner. There may be a second 'franchise' box on the right: theoretically the owner in this example could also develop a (range of) brands and become the franchisor. Who's to say The Hotel or Hotel BLOOM! will not grow into a franchise brand?

At the end of the classroom discussion, the instructor could address the very first question again: have students changed their opinion, assessment of the Pandox business model?

References

Eringa, Klaes and Jin, Perry Yi (2013). How to develop student-centered management cases. Research in Hospitality Management 3(1):39-49.

Additional Reading

Armitstead, Martin (2005). Hotel management and operations options: Intellectual capital versus financial capital. Journal of Retail & Leisure Property 3(4), 299–306.

Collins, Stephen and Perret, Sophie (2015). Decisions, Decisions... Which Hotel Operating Model is Right for You? http://www.hvs.com/article/7303/decisions-decisions-which-hotel-operating-model-is-right/. [Accessed the 14th of June 2016].

DeFranco, Agnes and Lattin, Thomas (2007). Hospitality Financial Management. Hoboken: Wiley.

Eyster, J. and deRoos, J. (2009). The Negotiation and Administration of Hotel Management Contracts. New York: Pearson Custom Publishing.

Schlup, Robert (2004). Hotel management agreements: Balancing the interests of owners and operators Journal of Retail & Leisure Property 3(4), 331–342.

Sharpe, Isadore (2012). Four Seasons - The Story of a Business Philosophy New York: Penguin.

A last source of relevant information is the website of Scandic, Pandox' largest tenant: www.scandichotelsgroup.com. Interesting pages include (retrieved 14th of June 2016) Hotel Portfolio. http://www.scandichotelsgroup.com/en/hotel-portfolio/ (which has a breakdown of their leased, managed, franchised and owned hotels offering a 'mirror image' to Table 1 in the case).