OUTSOURCING IN THE HOTEL AND RESTAURANT INDUSTRY[1]

The recent economics of hotel and casino operations have driven operational changes in several departments including food and beverage ("F&B"), housekeeping, laundry, janitorial, airport shuttle service, and valet. Subcontracting or outsourcing has been one among several changes that employers have pursued in an effort to boost operating profit. According to a study conducted by the Hotel Employees and Restaurant Employees Union (HERE), subcontracting affects locals representing 85% of HERE's total membership.

This paper focuses on the subcontracting or outsourcing of food and beverage operations in hotels and casinos.

Hotel Food: Why Change the Recipe?

For years the industry has debated the economic viability of food and beverage departments. In 1996, food and beverage expenses in full-service hotels totaled 73.4% of departmental revenues.[2] By contrast, expenses for room departments totaled 25.1%[3] of room revenues. Payroll expenses for food and beverage totaled 37.7% of departmental revenues, while payroll costs in the average rooms department equaled only 14.5%[4]

Predictably, the hotel industry argues that in unionized properties the economics of F&B operations are even more difficult. In New York City for example, the Hotel Association has asserted that for every dollar taken in by a Union hotel's food and beverage department, 72 cents goes to payroll. By contrast, they contend that for non-

[1] The conference coordinators appreciate the assistance of Matthew Walker, Director of Research & Education, Hotel Employees and Restaurant Employees International Union, and law student Nathaniel Norton.
[2] Smith Travel Research, 1997 HOST Report for the year 1996.
[3] Ibid.
[4] Ibid.

union restaurants that figure is about 29 cents.[5] These numbers help explain why we so often hear that food and beverage is the most labor intensive and least profitable major operating department in a hotel – particularly a union hotel.

In all market segments, food and beverage operations are being downsized and automated to reduce labor costs. Consequently, the overall profitability figures for self-operated hotel food and beverage are improving. Between 1990 and 1996, food and beverage expenses in full service properties went from 87.4% of the department's revenues to 73.4%; while gross departmental profits increased from 12.6% in 1990 to 26.6% in 1996.[6]

The marked improvement in F&B profitability is related to an industry-wide trend to reduce payroll costs. While full-service hotels are employing fewer workers, particularly in the food and beverage area, extended stay properties with no food and beverage are being constructed at a faster rate than any other property type. Industry-wide the average number of employees per 100 rooms has dropped 7.5% from 81 employees in 1986 to 75 employees in 1995.

Given the special emphasis on restructuring food and beverage, profitability for hotel F&B operations has grown faster than that for rooms departments when we look at the hotel industry as a whole over the past seven years. This trend runs parallel to an overall improvement in the industry's gross operating profit for the same time period. From 1990 to 1996 gross operating profit rose from 22% to 35%, profitability of F&B operations nearly doubled from 13% to 25%.[7]

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[5] *The New York Times*, March 15, 1995, p. C1.
[6] Smith Travel Research, 1991 and 1997 HOST Reports, for the years 1990 and 1996.
[7] Smith Travel Research, 1991 through 1997 HOST Reports for the years 1990 through 1996. Figures are rough approximates.

The following table lays out some of the more specific motivations for a hotel changing its food and beverage operations:

Hotelier's Motivations for Changing Food and Beverage Operatations

Reduce Labor Costs	Labor costs are a significant percentage of food and beverage operations. The Clarion Hollywood, Florida, for example, reduced its food and beverage labor costs by 64% after converting the hotel's existing food and beverage operation to a 'Choice Picks Food Court.' The food court is designed specifically to use minimal labor. The New-York New York Casino in Las Vegas where virtually all food and beverage operations have been subcontracted to Ark Restaurants. The wage/benefit differential between what Ark pays its employees and what the Local 226 "Strip Agreement" calls for is about $6 per hour. Industry representatives candidly point out that in heavily unionized markets, they are more inclined to lease out F&B operations. They see it as a means of extricating themselves from collective bargaining agreements, citing higher payroll and stricter work rules as factors.
Increase room occupancy and create guest loyalty	Lodging analysts agree that however costly hotel food and beverage operations may be, they contribute significantly to the upscale property's ability to market itself. The fact that occupancy rates industry-wide are expected to drop slightly over the next couple of years means that all the more pressure exists for high-end hotels to make the necessary changes to provide distinctive food, preferably from a recognizable brand or chef.
Free up time to focus on 'core' business	This argument for subcontracting is based on the contention that hoteliers are not restaurateurs and that, in order to maximize efficiency and profit, a property's various departments should be left to the respective experts.
Establish a local clientele at the restaurant	Hotels are increasingly interested in generating a loyal following among local clientele to complement the in-house customer base. There is a demonstrated connection between a hotel restaurant's popularity among "locals" and its success with hotel guests. Conventional hotel restaurants have not adequately attracted this market. Brand-name restaurants and well-known chefs have performed better in this regard.
Earn steady rental income	The standard lease for a hotel that chooses to subcontract out its restaurant will generate 5-10% of gross sales and, in some cases, a percentage of net operating income. The arrangement arguably converts a financially unpredictable operation into a steady source of income.
Reduce Capital expenditures	The lease can be structured so that the subcontractor is responsible for financing restaurant furniture, fixtures, and equipment.

Hotelier's Motivations for Changing Food and Beverage Operations (cont'd.)

Benefit from joint marketing	Whether it's a leased or franchised operation, any regionally or locally known brand likely will do its own advertising and the hotel restaurant will benefit from these efforts.
Free up extra space for rooms, meetings or banquets	The re-modeling required for new restaurants -- be they franchised or leased – may involve scaling down to one restaurant, thus freeing extra space in the hotel. This is often the case when a coffee shop or similar operation is closed and a kiosk or grocery area is set up in the lobby.
Joint equity	In cases where a hotel enters into a joint venture with a well-known chef or restaurateur, both parties benefit from sharing risks and profits.

The New Modus Operandi for Hotel Food and Beverage

Several factors help explain management's decision whether to outsource. For example, hotels relying on large group or convention business may not want to close or give up control of banquet facilities. A hotel in a restaurant-saturated metropolitan area may do away with its restaurant(s) altogether. Hotels with unionized restaurants are more likely than non-union hotels to subcontract F&B operations.

Generally, we are seeing more hotels attempting to cut costs not only by leasing out their food and beverage operations, but also by entering into franchising or "branding" agreements, joint-marketing contracts and other forms of partnering with outside restaurant companies.

Hoteliers have three major options when seeking to change their F&B operations in order to reduce labor costs and/or break a union.

Downsize/Automate: Hotels can downsize their restaurant by shutting them down completely and directing guests to other restaurants, utilizing vending machines or kiosks, simplifying cooking with automated equipment and prepared foods, or consolidating different operations (coffee shop, lounge, restaurant) into a single multi-purpose restaurant. While the hotel will still be the employer under this model, downsizing by its nature eliminates jobs.

Example: Rather than reconfigure its hotels to meet the standards of brand-name restaurateurs and run the risk of loss of control, Hyatt has cut back to one restaurant per hotel.

Franchising, self-branding, contractual agreements: Chain hotels may pursue self-branding options or work with a regional or national franchiser. In an effort to shift employer status and break a union, some hotels may enter contracts with restaurants to operate joint ventures. In these cases it is critical to discern the actual ownership and management structure. These types of operations may require downsizing, automating and renovations.

Examples: As Hyatt has cut back to one restaurant per hotel, it has begun experimenting with its own "self-brands" such as *Perks*, a 24-hour gourmet and food store.

Holiday Inn Worldwide offers "Convenience Courts" to its franchises. Brands available include Little Caesar's Pizza, Blimpie Subs and Mrs. Field's cookies. Franchisees enter into a license with each brand individually. Holiday Inn prefers keeping banquet facilities self-operated.

Doubletree Guest Suites in Chicago began a joint venture with the New York Restaurant Group (NYRG) because the hotel's two restaurants were under performing. The companies pooled their resources and share costs, profits, and employees. The restaurants have been extremely successful.

Annual revenues have gone from $2.5 million to $7 million.

Subcontracting: Hotels may enter into a subcontract with a restaurant for use of restaurant space or operation of all food and beverage in the hotel. Hoteliers are more likely to follow this model if they can retain control over their room service and banquet functions. Hotels operating under this structure shift employer status to the restaurant.

Examples: Holiday Inn has entered subcontracts including one with Elephant and Castle Restaurants at multiple locations.

The MGM Grand introduced large-scale subcontracting to the Las Vegas Strip. It turned over to subcontractors two restaurants it had previously self-operated. It replaced its own Italian concept, Leonardo's, with Tre Visi, and its own Ocean Grill with an Emeril's New Orleans Fish House. MGM claims that the changes resulted in a 50% and a 40% increase in profits respectively.

An Illustration of a Subcontracting Failure

A less successful subcontracting venture by MGM had its birth at about the same time. In November 1995, MGM hired Restaurant Associates to take over operation of the casino's 750 seat coffee shop. RA was hired to run the casino's concept, the Studio Café, as a behind-the-scenes operator. It was, therefore, not an arrangement made to attract business, but was, rather, an attempt by the casino to avoid the losses normally incurred in running a coffee shop. The MGM traded the traditionally subsidized coffee shop operations, run at a loss to attract and keep gamblers inside, for a guaranteed profit from RA. MGM received minimum monthly payments of $42,000 or 12% of gross; whichever was higher. RA, in turn, gained the chance to make money – if they could operate more efficiently than the casino had. Less than a year later, the MGM Grand sued RA in an attempt to remove the operator. The casino alleged that the Studio Cafe was unclean, that the service was poor, and that RA had "refused to employ in Las Vegas a manager with sufficient authority and responsibility to correct the problems." By March 1997 MGM had succeeded and the Studio Café was back under the casino's control.

This sour deal demonstrated the lack of management control a resort can suffer when bringing in a subcontracting. It also may have shown the bind these subcontractors find themselves in, looking for shortcuts to squeeze profit out of what have been traditionally break-even operations.

Subcontracting: A "Solution" with Problems of Its Own

If a unionized hotel chooses to subcontract, the union will likely have a fight on its hands to preserve those jobs and their union status. HERE has taken on these challenges. For example, in a card check agreement, fifty Temple Bar & Grill workers at Caesars Casino in Atlantic City won Union recognition September 1 when the subcontracted food establishment opened. Similarly, at the "Star Trek" Restaurant at the Las Vegas Hilton, which is subcontracted and is owned by Paramount, workers built a strong organizing committee and secured union representation.

The following table lays out some of the liabilities, beyond a labor dispute, that befall a hotel which chooses to subcontract if food and beverage.

Downsides to Subcontracting Food and Beverage Operations