Tilleke & Gibbins

Carl Icahn's Letter to Apple: Lessons for Hotel Owners and Global Operators

David Lawrence
Consultant
david.l@tilleke.com

Part 1 of 5: Understanding the Owner-Brand Relationship

The recent news of "activist investor" Carl Icahn's 3,000 word-letter to Apple encouraging the release to investors of USD 50 billion in cash reserves allows for comparisons of the relationship between a hotel owner and a global operator.

For starters, let's think of:

1. The Hotel as the Company
2. The Owner as the Shareholder(s) in the Company
3. The Brand as the Board of Directors of the Company

Simplified Traditional Shareholder-Director Relationship in a Corporation

Separation of ownership (shareholders) from control (directors) is the reason corporations are permitted by law to have limited liability (as opposed to unlimited liability, like an entrepreneur who is forced into personal bankruptcy after a business failure). Shareholders own the company (not the assets directly) and the directors (appointed by the shareholders) manage the company. The directors are only required to seek the approval of the shareholders on issues fundamentally affecting the company (e.g., selling off all the assets or merging the company). A shareholder's primary voice is their vote: one share, one vote. If the management performs, the shareholders keep them. If not, they vote to remove and replace them.

"All Animals are Equal. But Some Animals are More Equal than Others." – George Orwell

The above model is too simple. "One share, one vote" does not account for shareholder politics and the ability of shareholders to group together and try to influence management's behavior directly, without waiting to vote. Enter activist investors—such as Carl Icahn—who, while holding only a small minority of shares, have influence in excess of their shareholdings. If Icahn views Apple's management as making unwise decisions, he stirs the pot with letters to other shareholders, television interviews, and whatever else is required to make his point. The concept is similar to that of soft power in politics. Icahn doesn't have the votes to remove management, so he has to resort to influence.

Comparing the Owner-Brand Relationship with the Shareholder-Management Relationship

The Owner may be viewed as the 100% "shareholder" of the "corporation" (Hotel) managed by the "board" (Brand). This would mean that, with respect to the Hotel, the Owner:

1. Would be entitled to 100% of the profits.
2. Could remove the brand at will.
3. Would not be required to invest additional funds.
4. Would not be responsible for any operational expenses or liabilities.
5. Would be assured that the directors were free of conflicts of interest.

But anyone who has been involved in hotel deals and looked at the accompanying suite of hotel management agreements knows that this just isn't the case. We have:

1. Management Fees (share of profits)
2. Performance-Based Tests for Termination (technical, complex procedure)
3. Capital Improvements ("mandatory" owner investment)
4. Indemnification; Taxes; Labor; and Insurance (owner responsibility for operating expenses)
5. Exclusive Operation Area (brand can drive business to other owners)

What Owner in their right mind would agree to choose management that dictates these kinds of terms? None, it would seem. But stepping away from theory, reality shows us that branded hotels are everywhere. New branded hotels continue to be developed and existing hotels continue to operate. While all branded hotels are not profitable to both owner and brand, certainly enough must be to keep the cycle going. The model is missing something.

The Brand as the Board and CEO

The model is missing the CEO analogy. Many of today's top CEOs are confident, commanding, high-salaried, performance-driven, flashy, demanding, resource-intensive, take charge, and get-out-of-my-way kind of leaders. And they command a premium because they believe they can out-perform the crowd. The global brands appear to have many of these qualities, both good and bad.

Owners as Activist Shareholders

Of course, Owners hold the ultimate power over their Hotel, regardless of what any contract says. The problem is that the "nuclear option" (termination by any means) typically causes significant collateral damage and, unless used, becomes an ineffective deterrent for "bad" management behavior. Tossing out the Brand, however, is not the Owner's only right. Owners must negotiate with the Brand to obtain a variety tools that allow them to effectively *influence* the operation of the Hotel without needing to resort to *interfering* with operations, except when necessary.

Typically, an Owner doesn't want to *interfere* with operations, just as Icahn doesn't want Apple to bring iPhone production in China to a halt. Icahn just wants Apple to cut a bigger check to the shareholders, as an Owner may want the Hotel to be more cost concerned to maximize profits. Icahn may not like Tim Cook, but he's willing to put up with most of Cook's demands and idiosyncrasies because, in the end, he believes Tim is right for Apple. Similarly, the Owner believes the Brand is right for their Hotel.

Conclusion

The Owner-Brand relationship is complex and dynamic, ranging from high-fives to downright hostility. But, in the end, both parties are on the same side and looking for one thing: *to make money from a hotel they can both be proud of*. While the Brands could do a lot more to comfort and appease owners, they've proven themselves as effective operators for decades. Owners, especially new owners, need to understand the Brand, understand themselves, and understand when and how to use the tools upon which they've agreed (and a few they haven't...), in order to maximize the value of their asset primarily through *influence*, not *interference*.

Supalai Grand Tower, 26th Floor, 1011 Rama 3 Road, Chongnonsi, Yannawa, Bangkok 10120, Thailand
T: +66 2653 5555 F: +66 2653 5678 E: bangkok@tilleke.com