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News

Opportunities emerge for international hotel operators in Spain

By Matlin Associates on 9/17/2010

In this article:

SPAIN International hotel brands including Conrad, Four Seasons, Park Hyatt, Sheraton, Marriott Courtyard by Marriott or Mövenpick can be found in emerging market capitals such as Istanbul and throughout the world, but none are present in Spain's two most important cities, Madrid and Barcelona.

If there is one single feature that stands out more than any other in Spain's hotel industry, it is the scarcity of leading global hotel operators. In the upscale and luxury segments in Barcelona, only Mandarin Oriental, Ritz-Carlton and W are found, while in Madrid there is only InterContinental, Westin and Orient-Express.

Numerous coincidental factors have contributed to this phenomenon. Spain's real estate "boom" (now gone "bust") meant that many developers, with easy access to bank finance, often undertook ambitious large-scale projects that often required hotels, due to Spain's ill-thought-out zoning ordinances. Often family owned, led by self-made CEOs, they were attracted by the appeal of building a hotel that would give them more status than mere residential or office buildings. Matters were aggravated by deciding to operate as well as develop the hotel, often creating their own brands in the process—Rafael Hotels, Habitat, Selenza Hotels and Jale Hotels, to name a few. In Spain's coastal regions, a 5-star hotel, often with an accompanying signature golf course, was seen as an essential marketing component to sell overpriced condominiums and houses being built in resort communities, sometimes with thousands of homes.

However, the absence of foreign operators in Spain's principal cities cannot solely be blamed on these factors. The unwillingness of global brands to invest in, acquire or lease hotels has also been a key constraint—their refusals to put their money where their mouth is, in a market full of domestic operators such as NH Hoteles, AC, Hesperia, Silken, Abba and others that have been willing to do so—has too often left them out of the game. Even when teamed with a real estate investment partner, they were often too slow relative to the "due diligence-light" Spanish companies.

Naturally, in a pre-recessionary world, this led to significant increases in asset prices, often to levels that foreign funds found made no sense at all. In fact, professionally managed real estate investment funds essentially do not exist in Spain, with few exceptions—and apart from the publicly listed Spanish real estate groups such as Metrovacesa, Colonial or Sacyr-Vallehermoso, whose investments in hotels have always been a residual activity.

The Spanish real estate groups have generally approached hotels one of two ways. First, developing and operating the hotel themselves. In these cases, rarely if ever were professional advisors hired, nor feasibility studies undertaken. As running a 5-star hotel is more status-building than running a mid-market or budget hotel, investments were often far too high for the local market and over-dimensioned. In some cases, hotels were not well-designed from an operational perspective, and materials used were poorly selected for hotel operation.

The second scenario, which has proven marginally more reasonable, has been to develop or acquire hotels under lease to Spanish operators. Historically, the Spanish investor, especially the wealthy private hotel owner, has found great security in a lease-contract, typically a fixed amount per key, annually indexed to inflation. Naturally, few foreign operators were prepared to consider anything other than management contracts—something wholly anathema to them, following the asset-light trend first started by Marriott International in 1992 and which virtually every global operator has imitated since. However, during a recession, many hotel owners have discovered that there is far less security in their leases than they believed when the operators have offered the stark choice of reducing the rent or returning the keys to the building. Few owners, to date, have chosen the latter option for a lack of a better alternative.

The blame for this partially resides in that, in general, Spanish hotel chains are subscale and badly lacking in international brand recognition, as well as the resources and skills to develop sales and marketing, staff training and procedure and process programs needed to obtain the best operational results from a hotel. As a result, most Spanish hotels do not operate anywhere close to international standards, as many millions of foreign visitors to Spain can confirm. This has also been a very significant barrier to their international expansion, where they cannot compete.

Of course, the lack of an international brand means that the ADRs and occupancies that these hotels achieve are also substantially lower than what an international brand might obtain. Unquestionably, therefore, significant revenue and profits are foregone by the operators and owners in at least Spain's two principal cities, as well as other secondary cities and resort destinations, with meaningful international visitors.

The opportunity going forward

As Spain enters its third year of recession, the deepest experienced by the Spanish economy since the civil war of 1936, there have been very few hotel transactions or hotel M&A activity to date, but this is poised to, and must, change. The most important transaction in the past two years has been the forced marriage of NH Hoteles with Hesperia, as a result of which Hesperia—a much smaller independent operator, whose owner was a 25% hostile shareholder in NH—has been forced to cede management to the larger NH in order to seek the economies of scale that NH, Spain's most global hotel chain with revenue of over €1 billion, can presumably deliver.

Many smaller groups, some of which are aforementioned, are facing increasing pressure by banks to reduce their debt, to merge with stronger chains or put themselves on the block. The Spanish hotel industry owes billions of euros, mostly to domestic banks and "cajas de ahorro," or savings banks, meaning that in many cases the de facto owners of the hotel assets and operators are the financial institutions that have been seeking to stave off foreclose on the loans given the hits that they have already been forced to take in the residential market and which has so eroded their capital.

In this context then, we believe that Spain—which remains a global powerhouse in tourism, with more than 50 million visitors per year—perhaps more than at any time in its recent past, and especially in Madrid and Barcelona, represents an opportunity for global operators who, up until now, have been unable to enter the market. The international brands need to be proactive and demonstrate certain flexibility on their part. Just as it makes no sense for the Spanish hotel owners to be unwilling to consider management contracts, neither does it make sense for international operators to pass up acquiring well-located hotels or to lease them if the terms are sensible. Nor should the acquisition of some of these chains be discarded; deals can and will be struck, although few companies will put up the "for sale" sign and hence the need for taking the initiative. While it is clear that the Spanish economy will be slower to recover than the rest of the EU-5, now is the time for global operators to begin seeking to address their historic absence from the Spanish market. The opportunity is there to be seized.

Matlin Associates is a Madrid-based hospitality and leisure strategy consultancy and corporate finance firm. Stephen J. Matlin, its founder and managing partner, and Óscar Pérez, partner, possess over 35 years experience in the industry as executives and advisors.