Configurations of Management Agreements in Hospitality Industry - Adaptations to Remuneration, Termination and Loss Compensation due to Uncertainty -

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Summary

Research questions: How are management agreements in the German hotel market configured as reaction to the growing uncertainty? Which adaptations are made to management agreements in Germany according to their uncertainty reducing effect? Is a higher level of flexibility negotiated into management agreements, in order to encounter uncertainty?

Methods: Semi-structured expert interviews, forming a cross section of the target group being involved in the negotiation of management agreements, and giving insights about the driving forces and trends of the contract configuration.

Results: Agreements are flexibilised in the area of remuneration and termination, whereby safeguarding is predominant in the areas of loss compensation. Negotiation power has a higher influence on the contract configuration than uncertainty issues.

Structure of the article: 1. Essay; 2. Literature Review; 3. Hypothesis & Research Method; 4. Detailed Empirical Results; 5. Conclusions; 6. About the Author; 7. References

1. ESSAY

The high investment intensity of the hospitality industry, which is due to real estate, facility and equipment requirements, led to different operating modes, which separate the real estate investment from the hotel operations. These operating modes are settled in lease or management contracts. According to the Bundesverband öffentlicher Banken Deutschland (2007), 95% of worldwide hotel contracts where a variation of management agreements. In EMEA (Europe, Middle East and Africa) management agreements formed the major model in 2012. 28% of the hotels where managed under a management agreement compared to 19% lease and 25% in vacant possession, other concepts were each under 11% (Jones Lang LaSalle 2013a). In the German market of branded hotels in 2012 management agreements only reached about 8% to the benefit of lease agreements (22%) (Hotelverband Deutschland (IHA) 2013). Noticeable is the development of management agreements which have grown their quota by 30% in 2013 (from 5.8% to 7.8%) compared to 2001 (Hotelverband Deutschland (IHA) 2013). Especially international hotel operators are pressing the use of management agreements instead of lease modes, due to international accounting principles (USGAAP and IFRS, Jones Lang LaSalle 2013c, FASB 2013). This shows how the management agreement is, slowly but steadily, gaining relevance also in the German hotel transaction market.

While there was a trend towards management agreements, which separated the overall business risk for the owner from the responsibility for investment returns with the operator, the industry is now experiencing a drift towards hybrid contracts. Hybrid contracts in a

broad sense bring the lease contract and the management contract closer together. From the view of the management agreement, this means extending the classical contractual framework, by additional clauses, which aim at aligning goals and sharing risks (Linder 2013).

Operators and owners, acting within management agreements, are nowadays increasingly facing challenges emerging from the volatile and uncertain market developments. These include the economic recession, which has been particularly brutal to the hospitality industry (Hagel 2012), the threatening bankruptcy of Greece, causing the whole European Union to sway and the new e-commerce systems, altering the overall business trade. In addition to these anyhow increasing risks and uncertainties of international markets, the principal-agent relation between operator and owner in management agreements add another portion of uncertainty for both players.

While today's literature is mainly discussing the overall constellation of management agreements, often focusing on the American market, insights to the German market are rare. Likewise, there is little confirmation in research about the impact of uncertainty on the contract configuration.

These circumstances beg the question, how owners and operators, focusing on the German hotel market, react to these growing uncertainties in the configuration of their management agreements. The goal of the study conducted therefore was, to analyze the adaptations made to management agreements in Germany according to their uncertainty reducing effect. Thereby also identifying adaptations made to the configuration of German hotel management agreements due to uncertainty factors. This article focuses on the areas of remuneration, loss compensation and termination. The empirical study additionally covered the areas: duration, participation in business routine and capital provision, which will not be subject to the paper at hand.

An emphasis on the flexibilisation of contractual frameworks in an uncertain environment was found in literature. Besides that the first part includes an illustration of the basic setting of management agreements and an analysis of the adaptations to uncertainty found in current research.

From the analysis of the current scientific knowledge and own evaluation of the uncertainty effects, a hypothesis was derived. This assumed an increase of flexibilisation of the configuration of management agreements. Sub-hypotheses supporting the growing flexibilisation in the areas of remuneration, termination and loss compensation assumed a flexible fee and reimbursement payment adapting to the external environment and hidden actions of the operator. An increase of including termination arrangements upon bad performance of the operator, adaptable performance measures linked to these EXIT-clauses and flexible termination arrangements upon sale also for the operators would be indicators for a flexibilisation of the management agreements to encounter internal uncertainties. The last area, loss compensation would support the hypothesis, if guarantees are seldom stipulated and, if anyhow a guarantee is at place, a CAP clause would be negotiated. Testing the hypothesis and sub-hypotheses was performed by semi-structured expert interviews in August 2013. Twelve experts, being hotel operators or investors or coming from hotel consultancies, law firms of a bank formed the sample. Focusing on the German hotel market, this study was designed to explore the driving forces of contract design, picture the current constellations of management agreements and test the hypothesis of a growing flexibilisation.

The study could identify some areas in which flexibility for the parties was enhanced. Looking at the sub-hypothesis the predominance of percentage-based and commission-based remuneration could be confirmed. The inclusion of termination possibilities for the owner in the context of bad performance could be confirmed, whereby the flexibilising effect was limited due to a restricted execution possibility. Adaptable performance measures where found, in contrary the termination possibilities upon sale for the operator were disproven. Looking at loss compensation, the assumption of seldom stipulation of guarantees was disproven. Only the CAP clause, having an indirect flexibilising effect could be confirmed. The indicators for flexibilisation in the areas of remuneration, termination and loss compensation could not fully support the overall hypothesis.

Even so the hypothesis could not be fully confirmed. Instead implications were found that safeguarding and risk-sharing clauses dominate the negotiations of current hotel management agreements in Germany. Furthermore the negotiation power of the parties involved was identified as driving force behind the contract design and therefore superseding uncertainty issues. The paper gives insights in the clauses included in German management agreements and analyses the effect of different clauses to uncertainty situations and ramifications.

2. LITERATURE REVIEW

Fundamentals of Uncertainty

Uncertainty describes future events to which one is unable to account probabilities and lacks information about cause-effect relationships and decision outcomes. A distinction will be made between external uncertainty arising from the complexity, dynamism and munificence of the environment of an organisation, and the internal uncertainty (behavioural uncertainty) arising from the possibility of opportunistic behaviour of, and information asymmetries between, individuals of an

organisation (Williamson 1985, Dunn 2000, Jogarathnam & Wong 2009, Langer 2011, Poeschl 2013, Hilmerson & Jansson 2013).

Sources of Uncertainty

External sources of uncertainty can be described by the micro and macro environment of an organisation. Here fore the 5-Forces-Model (Porter 1980) and the so-called PESTEL-model (see in more detail Hungenberg & Wulf 2011) are helpful concepts to structure the external sources of uncertainty. Jogarathnam and Wong (2009) define the dimensions dynamism, complexity and munificence as main drivers of external uncertainty (Jogarathnam & Wong 2009). Dynamism describes the instability, variability and volatility of the environment, complexity creates uncertainty, by the lack of cognitively apprehension of the heterogenic and complex environments and the third dimension, munificence refers to the limited environmental capacity, e.g. scarcity of resources (Jogarathnam & Wong 2009). Table 1 shows examples of threats and ramifications possibly being initiated by external uncertainties.

Table 1 Examples of Possible Threats and Ramifications through External Uncertainties

Dimensions	Environment	
	Micro	**Macro**
Complexity		
Manifestation	- defining potential competitors - seeing potential threats by competitors - understanding customer demands (e.g. desires of foreign guests) - estimating effects of new market entrants	- assessing effects of recession - understanding legal settings - understanding global ecological requirements - assessing effects of capital market shifts - assessing effects of Greece's bankruptcy
Threats c.p.	➢ out-dated hotel product ➢ missed opportunities ➢ underestimating threats	➢ obstacles in sales/trade ➢ missed revenues ➢ image damage (e.g. ecological)
Overall ramification c.p.	decrease of demand → of revenue → of profits	decrease of demand →of revenue → of profits
Dynamism		
Manifestation	- change of competitors - demand changes - new guest preferences - evolving of para-hotel products - changing procurement methods	- growing ecological awareness - decrease of purchasing power - natural catastrophes (e.g. flood Germany 2013) - political unrest (e.g. Egypt 2013) - evolving e-commerce systems - increase of mobile devices, new room equipment
Threats c.p.	➢ late reaction to opportunities and threats in new demand ➢ overrun by substitutes ➢ product not meeting guest demands ➢ higher procurement costs ➢ higher distribution costs	➢ lacking innovation ➢ out-dated hotel product ➢ downturn of tourism ➢ damage to brand and image ➢ higher distribution costs ➢ inability to maintain business
Overall ramification c.p.	increase in costs → decrease of profits decrease of demand → of revenue → of profits	increase in costs → decrease of profits decrease of demand → of revenue → of profits
Munificence		
Manifestation	- problems concerning heating oil, seasonal food supplies - power of sales intermediary HRS - scarcity of locations - saturation of German market	- lack of personnel (due to demography) - bankruptcy of banks - price increase for loans
Threats c.p.	➢ higher procurement costs ➢ higher commission payment ➢ rising competitive pressure ➢ decrease in guests	➢ higher personnel costs ➢ rising recruitment costs ➢ increase of education effort ➢ higher capital costs
Overall ramification c.p.	increase in costs → decrease of profits decrease of demand → of revenue → of profits	increase in costs → decrease of profits

It shows, that most of the threats would c.p. (ceteres paribus) result in revenue decreases and reduction of profitability. For the parties in a management agreement, this would mean, that the negative outcome of external uncertainties would show a decrease in profitability. For the analysis of adaptations to market uncertainties, this means negative external uncertainty factors will show as revenue or profit downturns to the operator and owner.

The Principal-Agent-Theory serves as a concept to understand internal uncertainty sources, how they evolve and how they may be reduced. It can be applied in the context of management agreements, due to the relationship of an owner employing an operator to manage his property. It was developed within the context of the New Institutional Economics and based on an article by Jensen and Meckling (1976), examining the consequences of asymmetric information between contractual partners (Jensen & Meckling 1976). Basis of the theory is the fact, that a principal employs an agent to act for and on behalf of the principal. The primary reason for doing so is that the agent would normally have an advantage in terms of expertise and information. But a principal can never be sure that the agent fulfils the assignment to his full satisfaction, as he is following his own interests. So how can the principal enforce that the agent acts in his best interest and vice versa, the owner in the interest of the operator?

It is significant for the existence of a principal-agent relationship, that the actions of a contractor (agent) do not only have impact on his wellbeing, but also on the benefit level of the employer (principal) (Picot, Dietl, Franck, Fiedler, & Royer 2012, also Werners & Schlaghuis 2004, Ménard 2008, Meinhövel 2004). A very precise definition of, when to speak of a principal-agent relationship is stated by Meinhövel (2004). A principal-agent relationship describes the contractual relationship between two people (or organisations) in which the agent has the obligation to fulfil his assignment for the principal in exchange for remuneration. This implies the necessity of accordance, excludes complaisance because of the remuneration, also excludes the sale of material goods and implies service activities and the term assignment also connotes a certain freedom of action (Meinhövel 2004). Additionally one assumes, that the external environment of the principal and agent overlays the results of the agent's actions. Therefore, the principal cannot draw his conclusions about the actions of the agent alone by looking at the results (Schumann, Meyer, & Ströbele 2007). This shows the information asymmetry, which is prevalent between both parties. The uncertainty results for the less informed party, due to the information asymmetry and due to the fact, that information is not available without cost (Sandstede 2010). In addition to the information asymmetry of the parties, the risk of opportunistic behaviour withholds further uncertainties.

One can define three manifestations of hazards resulting from the information asymmetry in combination with opportunistic behaviour and further external disturbances. These are hidden action (possibility of the agent carrying out hidden activities, without the knowledge of the principal), hidden information (information advantage about disturbance variables, disregarded or seized opportunities and threats, same as external uncertainties an agent gains while fulfilling his duties) and hidden characteristics (agent may not have the characteristics, abilities or other, required to fully satisfy the assigned obligations) (Meinhövel 2004). In literature this term is mainly discussed one sided, as being a problem of the principal. But there are situations, where the principal also may opportunistically exploit his information advantage to the detriment of the agent: e.g. a principal starts negotiations with a potential buyer of the real estate, without informing the current operator about his sale plans.

Counters of Uncertainty

Ménard (2008) suggests that uncertainty can be counteracted by flexibility, leaving the possibility to react to new and changing situations; leverage of information about complex environments, which helps to control the situation; and safeguards which helps to mitigate the influence of uncertain future events (Ménard 2008).

Flexibility has been stated several times in literature as a reaction to uncertainty (Sanstede 2010; Hagel 2012; Werners & Schlaghuis 2004; Jogarathnam & Wong 2009). Jones Lang LaSalle (2013b) also state in their outlook for the hospitality industry in 2013, how the uncertain periods of natural disasters and political unrest (e.g. in Egypt, Tunisia) demand flexibility from investors and operators (Jones Lang LaSalle 2013b). Flexibility will be defined hereinafter as the capability to be responsive to change. In a contractual context this can be achieved by, not writing completely specifying agreements, but by leaving contracts incomplete, serving as frameworks and permitting sequential decision-making (Werners & Schlaghuis 2004; Dunn 2000). Incomplete contracts can be formed by incorporating if-conditions, only regulating the necessary events or aligning goals, instead of detailing the course of business and therefore enhancing control. Consequentially both parties retain a certain freedom in action and adaptability. In the principal-agent concept matching interests and therefore being able to reduce control are stated as a solution to hidden action, information and characteristics (Picot et al. 2012).

Information leverage has also been stated as possible reaction to growing uncertainty. Hilmerson & Jansson (2013) for example state that uncertainty reduces with growing experience (Hilmerson & Jansson 2013). Sanstede (2010) and Jogarathnam & Wong (2009) suggest, that an increase of information through scanning and screening of both events and trends of the external environment and the actions of business partners, help

to postulate probabilities and therefore form computable risks instead of uncertainties (Sandstede 2010; Jogarathnam & Wong 2009). Especially in the principal-agent relationship information leverage is emphasized as instrument to reduce uncertainties, which may occur through information asymmetries and result in hidden information, characteristics and actions (Picot et al. 2012).

According to Sandstede (2010) a safeguard against the negative results of uncertain events (like losses, damage of assets etc.) can for example be guarantees, spreading of liabilities, sharing of risks and insurances (Sandstede 2010). Regulations and agreements in contracts, which define the obligations and liabilities of all parties, will also serve as safeguard against negative outcome due to uncertain events (Weber & Mayer 2011; Evans, Kim, & Nagarajan 2006). The tools for reduction of uncertainty presented by different authors are summarized in figure 1. The leveraging of information is allocated to the ex ante tools, whereas flexibility and safeguards are more likely effective counters in an ex post view.

Figure 1 Overview Instruments of Uncertainty Counters

	Uncertainties: External	Uncertainties: Internal
Leverage of Information (ex ante)	> scanning > screening > experience > enhance cognitive capabilities	> control mechanisms (monitoring, reporting, signalling, screening etc.) > participation > experience
Flexibility/Adaptability (ex post)	> incomplete contracts > open rules > temination possibilities > less standardisation	> incomplete contracts > reduction of control (e.g. goal alignment) > freedom in action > termination possibilities
Safeguards (ex post)	> insurances > ressource pooling	> guarantees > fixed rules > liabilitiy allocation > risk sharing (goal alignment)

On summarizing the literature reviews on uncertainty reactions, it is notable, that the adaptability and flexibility of organisations are mentioned often. Also ex post adaptation to new situations was stated to be advantageous for reducing sunk costs, as well as extra effort investigated in scanning and screening the environment. It should also be considered, that the probabilities of uncertainties are not assessable. The overall conclusion could be that gaining flexibility would be the preferred tool to counteract uncertainties.

Definition Management Agreement

The term management agreement stands for a contract type, which is not explicitly governed in German law (legally based on an agency agreement German Civil Code (BGB) §675 with characteristics of a contract of employment BGB §611), between an owner, owning the hotel real estate and an operating firm, which operates the hotel business on behalf and on account of the owner (Donhauser & Fuchs 2008a, Eyster 1977). This means, an operator is obliged to manage the hotel of the owner, in his interest, on his account and risk, as well as normally in the name of the owner (Schlup 2000). Therefore the operator fulfils overall operational functions and parts of the decision authority. Whereby the owner bares the overall business risk of profit and loss (Donhauser & Fuchs 2008a). In contrast to a lease agreement, it enables a hotel owner to retain legal ownership of the hotel site, building, plant and equipment, furnishings and inventories, while the operator assumes responsibility for managing the hotel's day-to-day business (Turner & Guilding 2010).

Basic Framework of Management Agreements

The roles of both parties can be defined differently depending on the negotiated agreement, though in the basic framework one would assign the following roles: Next to the risks of the investment, the owner bears the overall business risk of hotel operations, he provides the operator with necessary capital, pays the negotiated fees, although only having limited right of participation, he employs the personnel of the hotel, owns the whole property including FF&E (Furniture, Fittings, and Equipment, all machines and loose assets of the hotel), arranges the maintenance of the building, he has full liability for the course of business and provides the operator with a fully functional hotel property. The role of the operator is to manage the hotel in the best interest of the owner, he receives a fiduciary possession of the property, he is responsible for gaining a reasonable GOP (gross operating profit), reacting to external conditions, defining the concept of the hotel and strategy, same as the overall management functions of a hotel manager, i.a. these are the service operations, market-

ing, accounting, etc. These roles and obligations show the close alliance between owner and operator, needed for a management arrangement.

There are generally two types of operators; independent and branded. Agreements with independent operators normally contain a franchise clause or they specify a hotel without international brand commitment examples are Treugast Solutions Group and Event Hotelgruppe. Branded hotel operators are those, who belong to an overall brand organisation for example Hilton, Accor or Intercontinental. Usually hotel operators are not individual persons but operating companies (Jaeschke & Fuchs 2011). The owner can also be specified in different company concepts, for example individual investors and funds like Deka, Union Investment and Commerz Real, which are German investors. International Investors are also private equity investors, funds, real estate investment trusts (REIT), or real estate companies like ADIA, MSREF, Blackstone or Invesco Real Estate (Schwaeppe 2012, Linder 2013, further information about REITs in a hotel context can be found in Fuchs 2008).

Next to the management agreement, the lease mode is prevalent in the German hotel market (Fidlschuster & Linder 2013, Hotelverband Deutschland (IHA) 2013). For a better understanding, a short distinction of these two modes needs to be made. The lease contract obliges the lessor (owner) to grant the use of the lease item, in this case the hotel property, in the contractual scope, while the tenant (operator) is obliged to pay the agreed rent (Donhauser & Fuchs 2008b). In comparison to the management agreement the loss compensation will take place by the operator, the owner will, on a contractual basis, not bare the overall business risk (Donhauser & Fuchs 2008b). Investors entering the hotel real estate market in order to enhance their value growth potential, would benefit from the management agreement compared to the lease mode due to the following reason: Because the management agreement can achieve higher yields during the investment period, as no risk buffer will be deducted from the lease payments and profits will be directly transferred to the owner; and a continuous adjustment of the property value to current hotel and capital market conditions will take place (Ohler 2008). In return the owner bares a higher risk of losses.

In literature the discussed areas of management agreements are summarized such, that the general framework of the contracts governs the remuneration of the operator, including his fees and system reimbursements for overhead functions like reservation system, marketing activities etc. (Detlefsen & Glodz 2013, Harnish 2010). In a very basic framework the fee would be a management fee, for example 3% of the revenue. The system reimbursements used to be a fixed sum or revenue percentage paid to the headquarters of the operator for central services. The duration and termination of the contract is negotiated. In a basic setting this would be a term, around 20 years (Eyster 1988b) with no premature termination possibilities. In a very plain management agreement, operators would have full freedom in the course of business, without participation of the owner. Normally the owner would have the right and obligation to employ the staff. All capital needed for the business routine and investments, is provided on the owner's account, with access rights for the operator. It is the owner alone, who is liable for losses, as he also gains the profits. Nowadays, further adaptations to this basic framework have evolved and been negotiated in several management agreements.

The paper at hand will focus on the clauses within the areas of remuneration of the operator, termination, and loss compensation, leaving out the adaptations made in the duration, business routine and capital provision due to the scope and complexity of the subject (see for important dimensions of management agreements Eyster, 1988a, 1988b &1993, DeRoos 2010, Turner & Guilding 2010, van Ginneken 2011, Detlefsen & Glodz 2013, Linder 2013).

Adaptations to Uncertainty due to Literature Review

The literature review showed adaptations to the basic setting of a management agreement. They therefore seem to include all three tools of uncertainty reduction, information leverage, flexibilisation and safeguards. Especially arrangements increasing flexibility for either party were prominent in the current articles about management agreements.

Remuneration

The management fee is usually split into a basic and an incentive fee. Commonly 2%-4% of the gross revenue is paid as a basic fee. Whereby the percentage is normally higher for brand operators (mean of 3.8% compared to 2.95% for independent operators, Detlefsen & Glodz 2013). The higher payments for brand operators could be explained by their higher reputation, therefore lower perceived risk for the owner and their bargaining power. Examining the uncertainty aspect, brand operators can reduce hidden characteristics, by signalling methods, like reputation, recommendation, references and explanation of the immaterial service, which reduces the perceived uncertainty for owners. Owners may choose brand operators, even though brand operators usually have a stronger bargaining power and negotiate higher compensation fees (Beals & Denton 2004).

Because the basic fee is normally tied to the revenue performance, owners encourage operators to maximize their income goals, by leveraging the revenues rather than the profit, as would be beneficial for the owner. This involves the uncertainty of hidden action (see also Evans et al. 2006). As compensation forms one important factor of the operator's goal system, he will try to maximize his compensation. Therefore it is not important for him, if this happens to the detriment of costs or cash flows. The owner on the other hand seeks a high

ROI, whereby the profit and cash flows play a crucial role. Here we have a typical principal-agent problem, harbouring the uncertainty of hidden action. As an example, the operator could boost expenses in marketing activities in order to enhance revenue, but minimizing profits. This uncertainty could be counteracted by goal alignment, which has the benefit of not causing extra controlling costs for the owner, but leaving the operator freedom in action. A common concept of goal aligning compensation is an incentive payment (Evans et al. 2006, Turner & Guilding 2010).

Detlefsen and Glodz (2013) report five different calculation forms for the incentive fee:
- available cash flow after owner's priority (stand aside or subordination of fees)
- operating cash flow (income before income taxes),
- gross operating profit over incentive fee threshold,
- positive variance from budget and
- positive variance from prior operator.

With the first method, 'available cash flow after owner's priority', the operator would receive a percentage of the operating profit, which exceeds the target figure of ROI (Detlefsen & Glodz 2013). This is an incentive, which aligns clearly with one of the uppermost factors of the owner's goal system. In literature, this owner's priority is often also referred to as a stand aside clause or subordination of fees (Linder 2013, Schlup 2003, Armistead 2003). With the 'operating cash flow (income before income taxes)' the management company receives, similar to the prior method a percentage of operating cash flow, after deduction of the owner's priority and funds deposited into the reserve for replacement (Detlefsen & Glodz 2013). This incentive also has a positive impact on the ROI and liquidity situation of the owner, whereby the increase of value for the overall hotel investment is not considered. The third option is also based on the operating profit, the 'GOP over incentive fee threshold', allows a percentage of the GOP, but only after exceeding a specified hurdle amount (Detlefsen & Glodz 2013). With this method, the incentive aims at an important goal for the owner, the gain of profits, but it again inherits uncertain hidden action. As the incentive for the operator is to gain a high profit, he will in general not consider ROI, when deciding on investments, which is more relevant for the owner. For example an operator will enforce investments, which have short-term profit impacts, although ROI may be smaller than for an alternative investment. 'Positive variance from budget' describes an incentive, by which the operator receives a percentage of the amount of GOP, which exceeds the GOP budgeted for the year (Detlefsen & Glodz 2013). In this case there is the threat of hidden action, that the operator will force lower budgets for the year in order to leverage his compensation share, which leads to higher cash outs without any profit increase for the owner. The calculation method stated last is the 'positive variance from prior operators', which would only be used in the start-up phase, after a take over from the previous operator (Detlefsen & Glodz 2013). With this method the operator will be measured by a baseline formed from the performance of the prior operator (e.g. last GOP, operating cash flows or an average of them), and receive a percentage of the amount upon which he exceeds the baseline (Detlefsen & Glodz 2013).

Different incentive payment methods have also been analysed by Turner and Guilding (2010). However none of the authors found a solution, which fully aligns the interests of owner and operator. Gaps for hidden action could be identified in all measures (Turner & Guilding 2010).

Approaches used in the US and Thai markets, to negotiate contracts with an incentive fee only were identified. This would further reduce the threat of hidden action and characteristics for the owner and make the compensation more adaptable to the business performance. The owner increases the portion of free cash flow to equity, in the event of poor operator performance or bad external conditions, but operators have to take over extra risks, which would leverage their claim of higher percentages (Bader & Lababedi 2007, Panvisavas & Taylor 2008, DeRoos 2010). The basic fee compensation upon revenue forms a safeguard for the operators, against the uncertainty of market conditions and the existence of residual profits. This would, in combination with an increasing bargaining power of the owner (on growing bargaining power: Beals & Denton 2004, DeRoos 2010), be an instrument for owners to gain a higher security against hidden action and hidden characteristics. This reduction of uncertainty may lead to a loosening of control mechanisms and increase freedom of action for the operator. For the owner, incentive payments have a mainly safeguarding effect.

The second part of remuneration, the reimbursement for overhead services, can have multiple manifestations. Most commonly reimbursement is paid for marketing activities, like distribution systems and promotion efforts, but also for centralized accounting systems, personnel recruiting and administration activities (Detlefsen & Glodz 2013, DeRoos 2010). These fees can either be paid in a lump sum, as percentage of revenue (Bader & Lababedi 2007, DeRoos 2010) or can be paid commission-based (DeRoos 2010, Rouse 2004). With a lump sum payment, the parties may not be able to include variations due to external uncertainties. For example, when demand drops, the services for reservation will also decrease; the owner would therefore not want to pay the same amount as would be paid during high utilization. The commission-based payment changes fixed costs to a variable payment. It also has benefits for the operating company, as the reimbursements are one of two income streams, the operator will try to improve and leverage them. With a variable reimbursement, they can have a greater share of positive business developments. But this also applies to negative business development of cause. This would mean, operating

companies are willing to forgo fixed and safeguarded cash flows, to the benefit of a higher flexibility to market developments and profit chances; whereby owners gain flexibility to react to market shifts.

Concluding, the remuneration itself does not inherit uncertainties for the parties of the management contract. Instead it can have a positive impact on uncertainty reduction, by aligning the goals of owner and operator (Panvisavas & Taylor 2008). The generation of compensation fees plays an important role for the shareholder value of the operator. To the contrary the owner prefers lower compensation payments to therefore gain a higher profit range. The remuneration, applied accordingly, can serve as a tool for goal alignment. Important though, is that the remuneration system is clearly defined. The measures found for calculating the base and incentive fees all had in common, that they formed a percentage of some calculation base (e.g. revenue, GOP). This percentage allows the parties to respond to market fluctuations. In Addition commission-based payments allow to adapt to altered market conditions.

It could be assumed from the aforesaid that percentage payments of fees and variable payment of system reimbursements are predominant in management agreements, in order to try to achieve flexibility towards market volatility and uncertainties. Furthermore a shift towards the incentive fee could be assumed, in order to further enhance the goal alignment and reduce control by adapting the compensation directly to the performance of the operator.

Termination

In the original agreements, no termination rights were included, unless events occurred, which made it impossible to continue business, e.g. bankruptcy of the owner, natural catastrophe destroying the properties (Eyster 1988a). In general two common kinds of termination rights can be allocated, the termination upon under performance of the operator and termination rights for the operator, upon sale of the property (Schlup 2000, Ohler 2011, Hare & Barnard 2013).

The first case reacts to internal uncertainties, like hidden characteristics and actions of the operator, which would show in under performance (Hare & Barnard 2013). The second case combines two uncertainty aspects, one is the possibility for the owner to sell the property, reacting to external uncertainties, like a bad tourism demand and low profitability of the real estate. The other is a change of owners, which involves high uncertainties for the operator, which can be hidden information and action of the current owner and hidden characteristics of the future owner.

The difficulty in negotiating a termination right upon under performance is, to negotiate the right performance measures. Hare and Barnard (2013) and Ohler (2011) report two sets of performance measures, the budget vs. actual-test and the RevPAR-test (revenue per available room, which shows the revenue achieved in relation to the overall available room capacities).

With the budget vs. actual-test, the operator will fail, giving the owner a right to terminate, if the annual budget is not met within a certain percentage range (usually 80% to 90% of budgeted GOP or net income), several years in a row (Hare & Barnard 2013, Ohler 2011). In situations, where the owner does not have absolute approval of budget, this performance measure is questionable (Hare & Bernard 2013). Also from an uncertainty perspective, this measure has high conflict potential, as it may harbour hidden action of the owner. If he wants to terminate the agreement, for whatever reason, the operator may not know (hidden information), the owner has the possibility to press budgets year after year, with the result that the operator is not able to meet the budget. This may lead to lengthy court or arbitration proceedings.

A second method for performance measure, is the RevPAR-test, where the operator will fail the test, giving the owner the right to terminate the hotel management agreement, if the RevPAR of the hotel is less than a certain percentage (usually 80% to 90%) compared to the RevPAR of the hotel's competitive set (Hare & Barnard 2013, Ohler 2011). Two of the challenges with using the RevPAR test are the identification of a true competitive set for the hotel and obtaining accurate figures from the competitors (Hare & Barnard 2013). Especially the definition of the competitive set involves the uncertainty of hidden action and information. Here the owner may have information about a very good performance of a competitor and will therefore insist to add it to the competitive set. An advantage of the orientation of the performance measures to market figures is, that they will inherit certain flexibility, as they adapt to external uncertainties. Also giving the operator two or more years, to recover from performance failures, makes the arrangement adaptable and flexible. The fact, that the RevPAR alone only gives a limited view of the performance level, has to be considered a critical aspect. For example other incomes like restaurant, wellness, conferences and the bottom line are dismissed.

Another arrangement, giving both parties a possibility to terminate the agreement, but still leaving options to maintain the relationship, if the occurring situation makes it beneficial, is the inclusion of the right for the operator to cure shortfalls from the performance tests (i.a. Hare & Barnard 2013, Ohler 2011). As the owner’s returns on the property will only be on a minimum amount, if performance levels are undershot, he will limit the number of times an operator can cure during the operating term.

The possibility to terminate the agreement upon under performance has a positive impact on the uncertainty situation of the owner, as he is able to EXIT from the

contract, if the operator is not acting or not able to act to his benefit. Therefore, one could assume, that other safeguards, which try to unveil hidden action and characteristics will become obsolete. If for example the performance is measured by comparing a set of KPIs (Key Performance Indicators) such as RevPAR, GOP, operating revenue, operating cash flow and RevPAS (Revenue per Available Seat, is the counterpart of the RevPAR, but measures restaurant performance), to a market benchmark, the owner could reduce his transaction costs, by dropping participation rights in budget approval, personnel employment and other areas. Also clauses in which operators give guarantee for certain GOP figures can become obsolete with a well-negotiated EXIT-clause. This would reduce the pressure on the operator, with regards to having to consider future guaranteed obligations in accounting and having to spare compensation fees. As a result the owner would have to give up a certain amount of safeguard, but on the other hand, it offers a reason to negotiate lower management fees, as restraints for the operator concerning guarantees and accounting drawbacks are reduced.

One problem remains: even if performance measures are well negotiated and tied to market figures, as soon as economy in the hospitality sector is slowly declining, performance measures will easily be met – without a positive outcome for the owner (Crowell 2000).

This analysis may be concluded with the assumption that EXIT-clauses (termination upon bad performance) are negotiated increasingly, to give owners flexibility in their asset management, and the operator more flexibility in the course of business. At the same time performance measures should be kept adaptable to the market conditions (e.g. measures compared to cross-sectional comparisons), in order to be able to react flexibly to external uncertainties. Last also the inclusion of curing rights would flexibilize the relationship for the operator, whereby a limitation of the curing frequency will enhance the termination possibility and therefore flexibility for the owner.

The second termination right is linked to the sale of the hotel property, as the change of control inherits uncertainties for the operator, like hidden characteristics and information, not knowing the solvency and knowledge of the new owner. Operators negotiate different rights upon sale. These are the right of first refusal, which is a pre-emption right for the hotel property, a termination right, if the new owner is not agreeable to the operator and a non-disturbance agreement. The non-disturbance agreement means, if discordances between the owner and the bank should occur, these will not touch the existence of the management agreement. Additionally after execution of foreclosure the operator will be obliged to continue managing the hotel, also under the governance of the bank (Hare & Barnard 2013, Friebe & Wilkinson 2010, DeRoos 2010). These clauses give the operator the chance to adapt to the internal uncertainty of changed ownership. On the other hand, the flexibility of transacting the property will be reduced by pre-emption rights (Fidlschuster & Linder 2013).

This leaves the question open how these arrangements are truly negotiated in practice. Is flexibility in termination and retention, meaning the freedom to decide on how to continue after a change of ownership (upon sale) included in German hotel management contracts?

Loss Compensation

The general setting in management agreements is that the owner bares the overall business risk, and therefore may benefit from profit potentials. Especially, as the responsibility of business results lies with the operator, the owner needs to bare the risks for the outcome of the operator's actions; this inherits a big uncertainty and conflict potential. Arrangements have evolved, with which owners try to safeguard themselves against losses and take the operators to account for the outcome of their management. These are guarantees, stand-aside and CAP clauses as well as curing rights in the event of under performance (Schlup 2003, Bader & Lababedi 2007, Mücke 2007, Baurmann 2007).

The operator carries a higher risk and offers the owner additional safeguard, by giving the owner a guaranteed minimum interest return. The operator accepts to guarantee the owner a certain level of profit. In the event that this level of profit is not achieved, the operator guarantees to make up the difference from his own funds. Typically this kind of guarantee is accompanied by a right, which allows the operator to 'claw back' any payments made under a guarantee from future surplus profits (Bader & Lababedi 2007).

The arrangement of guarantees, even with claw back provisions, draws the management agreement closer to lease modes, as a big portion of business risks is transferred to the operator. These constellations would typically be found in hybrid contracts. As a consequence the operator will demand higher fee payments to compensate for the risk assumption (i.a. Schlup 2003). The consequence of an arrangement of guarantees, even with a claw back provision, is high pressure on the operators, who, by compensating for losses, partially assumes the role of a capital lender. This is a restraint, as operators in general are able to work with short balance sheets and can normally plan with stable and predictable cash inflow. Hence, operators may have major problems handling these capital sums.

The CAP-clause is another possible arrangement, which may be used in combination with an operator guarantee. Typically the operator places a limit ('cap') on the total guaranteed funds within a specified number of years (Bader & Lababedi 2007). This CAP can for example be in form of a reserve fund, from which the loss compensation can be withdrawn. As soon as the fund is exhausted, the operator has no further obligations to com-

pensate losses or cure shortfalls (Mücke 2007). This clause in combination with the guarantee gives both parties a certain safeguard against losses through a transfer of risks. If the CAP is reached, there are three possibilities with which the parties may proceed. First the owner can waive his guarantee claim and transfer the agreement to a non-guaranteed management contract. Secondly the contract can be terminated according to the negotiated terms either one or both sided. The third option is that the operator pays the losses anyhow in order to retain the relationship (Baurmann 2007). These subsequent steps inherit a certain level of flexibility for both parties, and if the guarantee with a CAP clause fails, after it has safeguarded both sides for a certain period, they have the opportunity to flexibly decide on how to carry on, according to the respective internal and external situation.

For Europe in general and the US, authors have stated that guarantees are seldom negotiated (Bader & Lababedi 2007, Detlefsen & Glodz 2013). This is due to the fact that operators accounting under USGAAP or IFRS have to form contingent liabilities for providing guarantees (Financial Accounting Standards Board (FASB) 2013). This causes higher costs and uncertainties for the operator with regards to capital funding. Another reason could be that operators gain negotiation power by granting a guarantee; therefore owners will lose flexibility in other areas. This evokes the question, what is more important for the owner, a safeguard by a guarantee or flexibility?

This discussion evokes the assumption that in German management agreements guarantees will rarely be stipulated to the benefit of termination rights upon under performance. But if a guarantee is negotiated anyhow, a claw back provision will be included, as this gives both parties the possibility to fulfill their obligations flexibly in time. Additionally a CAP clause is often integrated. On first sight indeed being a safeguard it offers both parties yet flexibility, as the clause goes along with a termination right upon longer-range deficits. In the case of no guarantee, but alone an EXIT-clause being included, the owner will grant the operator certain curing rights.

Table 2 summarizes the adaptations, which were described in literature and discussed previously with regards to their ability to reduce uncertainty.

Table 2: Adaptations to Uncertainty

Dimension	Sources of Uncertainty		
	External Uncertainty	Internal Uncertainty through (hidden action, characteristics or information)	
		Operator	Owner
Remuneration	➢ fee payment in per cent of revenue (flex) ➢ commission or revenue based reimbursement (flex) ➢ base fee for operator (safe)	➢ incentive payment (safe)	
Termination	➢ curing right for operator (flex) ➢ adaptable performance measure (flex)	➢ termination upon bad performance (flex) ➢ limited cure rights (safe/flex)	➢ termination upon bad performance (flex instead of control) ➢ decision right upon sale of property (flex)
Loss Compensation	➢ guarantee (safe for owner) ➢ claw back provision (safe for operator) ➢ cap clause (safe operator) ➢ termination right at end of cap clause (flex) ➢ omit guarantee (flex for owner)	➢ guarantee (safe) ➢ omit guarantee (flex)	➢ termination right at end of cap (flex)

Abbreviations: flex = flexibilising effect, safe = safeguarding effect, info = controlling/information enhancing effect

3. HYPOTHESIS & RESEARCH METHOD

Hypothesis

Concluding the analysis of adaptations to uncertainty, all three uncertainty-encountering tools could be identified in the respective literature. The tools, which enhance flexibility instead of information and safeguard against risks, were especially prominent. Current research also indicated that flexibility will play a major role in the future design of management agreements.

Therefore implied by the previous analysis the following hypothesis (H) will be put forward:

H: To counter internal and external uncertainties, both parties integrate flexibility in the contractual framework.

Different areas of flexibilisation of the management agreement could be identified. The presence of these clauses would have a positive indication for the confirmation of the above hypothesis.

An indicator for a higher flexibility in the context of remuneration would be the percentage- or commission-based payment of fees and system-reimbursements. The following sub-hypothesis (SH) reflects this indicator for flexible arrangements:

SH1: Percentage- and commission-based payment of remuneration is predominant.

Higher flexibility in termination would be revealed by EXIT-clauses. One often-discussed EXIT-clause is the termination right upon bad performance of the operator. Whereby in this context the performance measures would also be variable to the external market conditions. Termination rights for the operator upon sale of the property could also be identified as possible indicators for increasing flexibility.

SH2: EXIT-clauses (termination upon bad performance) are negotiated increasingly.
SH3: Performance measures are kept adaptable to the market conditions.
SH4: Operators ask for flexibility in termination, for example the freedom to decide on how to continue after a change of ownership (upon sale).

Arrangements regulating rights and obligations, if losses or insufficient profits are made, indicate flexibility, when guarantees are seldom negotiated. Also the existence of CAP clauses implies flexibility.

SH5: Guarantees are seldom stipulated.
SH6: More often a CAP clause is integrated in management agreements with an implemented guarantee.

Due to the complex and extensive scope and number of possible constellations of management agreements only the prominent clauses of the focussed areas emphasised in literature were integrated in this paper. It has to be kept in mind, that other arrangements and configurations are possible. At the end of a negotiation the parties will make sure, they meet their expectations and reach a reasonable balance between risk share and profit opportunities.

Method

In order to gain information about the existence of the clauses stated in the sub-hypotheses interviews were performed with experts in the field of management agreements. To be able to gain deeper insights to the constellation and driving forces behind the different clauses and to analyse the trends and developments of the contract design, the method of semi-structured interviews was applied. Semi-structured interviews are by their nature conversations with prepared and formulated questions, whereby the sequence is not relevant (Atteslander 2008). As a tool the interviewer used an interview guideline, which helped to check that all aspects were covered during the interview and gave suggestions how to ask different issues (Atteslander 2008, Schnell, Hill, & Esser 2011).

Next to the operators and owners negotiating or acting within management agreements, three further target groups were identified. These are hotel consultants, bankers and lawyers specialized in hotel management agreements, which have knowledge about a wide range of contracts existing in the German market and additionally are able to identify trends. Consultants and lawyers, have the possibility to give a broad view on different existing contractual designs and have experience with different constellations and situations by being part of the negotiation process. The consultants could be allocated to the two negotiating parties, operator and owner, by examining, which party they have advised. The second target group are specialized lawyers supporting the negotiating parties. They are also an important group with broad insights in management agreements. For a special view on the subject a third target group of financing banks is included. In some cases the financing bank was included in the negotiation process and could have great impact on the constellation of management agreements.

To be able to explore the possible constellations and configurations of management agreements, a broad and multi-various view to the subject is important. Therefore it was decided to include all five target groups in the research, hotel consultants, mostly with a focus either to the operator or owner side, lawyers, bankers and operators and owners. A focus was set to the group of hotel consultants, as these are able to give a broad insight about trends and developments, according to different uncertainty situations.

Twelve expert interviews were conducted. A cross-section of all target groups and different constellations of negotiating powers could be formed with the conducted sample, with an emphasis on the owner's view and negotiations from bigger branded operators. Anyhow, it needs to be kept in mind, that the sample is only an extract of reality and can only give limited insight to the variations and possible constellations of management agreements. The experts can also only give their subjective point of view. Whereby overlapping opinions and evaluations can be a good indicator for the German hotel management market, as the experts all have a very profound view on the constellation and motives of the negotiating parties.

The semi-structured interviews were conducted face-to-face, if time and the geographical distance allowed it. Otherwise a telephone interview was conducted. During telephone and face-to-face interviews the interviewee was able to focus on the interview situation and disturb-

ances were kept few. The interviews were recorded for later analysis (except for two interviews, due to the wish of the interviewees. Here notes were made during the conversation). The interviews lasted between 30 min and 1h15min. Whereby the interviews conducted in face-to-face lasted longer by the nature of the situation. Telephone interviews were finished after around 30 to 50 minutes.

4. DETAILED EMPIRICAL RESULTS

Remuneration

Display of Interview Results

The configuration of a base fee accompanied by an incentive fee was confirmed in the interviews like it is described in literature. The standard procedure would be a per cent pay alike 3-5% of revenue paid as base fee and 10-15% of the GOP paid as incentive fee. The experts also confirmed the existence of most calculation methods for the incentive fee. Especially the 'available cash flow after owner's priority', 'operating cash flow (income before income taxes)', 'gross operating profit over incentive fee threshold' and 'positive variance from budget' were mentioned by the interviewees. Seemingly less relevant is the 'positive variance from prior operator', as this was not mentioned by any of the interviewees. The 'available cash flow after owner's priority' and the 'operating cash flow' were most frequently named; followed by the threshold and variance from budget. Two further methods not mentioned in literature, were the scaled payments and subordinated base fees. The calculation methods can be summarized in five categories: per cent, fixed, scaled, hurdled and subordinated fee payments.

The different remuneration categories are displayed in figure 2.

Figure 2: Calculation Methods for Compensation of Operators

Category	Characteristics
Percentage	• standard procedure • base fee (3-5% of revenue) • incentive fee (10-15% of GOP, may also % of meeting budget)
Fixed	• foreclosures & distressed properties • weak owner, strong operator • high perceived uncertainty for operator • for initiation phase • small hotels
Scaled	• scales payment of base or/and incentive fee • similar to lease setting • high perceived uncertainty for owner • considers the develpment phases (initiation etc.) • secures owner's cash flows to pay bank
Hurdled	• hurdle of achieving performance or other measures (mainly of incentive fee) = gross operating profit over incentive fee threshold • alternative to a fee subordination and positive variance from budget • safeguards the owner against internal uncertainties • hurdled base and/or incentive fee possible
Subordinated	• payment of incentive fee only after distributing owner's or bank's priority =available cash flow after owner's priority and operating cash flow • regular procedure • guarantee-like arrangement • secures the owner, especially often for strong owner

The experts were united with the opinion, that fee payments in fixed sums are only seldom stipulated, but can still emerge, under special circumstances, occurring in the context of foreclosures, distressed properties and very small hotel businesses. Determining is the negotiation position of the parties; meaning that the owner has a poor starting position and the operator faces extraordinarily high uncertainty. In this case the operator will aim to negotiate a safeguarded fee payment. Especially an interviewed operator, who specializes in distressed properties, emphasised this case as a common setting in the initiation phase of their management relationship. As the ramp-up phase after foreclosures and in distressed properties will form a highly uncertain phase for the operator until revenues and profits have stabilized, the frequency of demanding a fixed fee is high. After a certain initiation phase the fee payment will then proceed with the standard percentage-based setting.

Scaled payments where mentioned as further constellations for management agreements. These are similar to fee settings in lease contracts. The scaling is supposed to consider different phases in the development of the hotel, similar to the above mentioned initiation phase. The experts did not mention further reasons.

The fourth setting for fee payments is the hurdled arrangement. This was mentioned by all experts, often also in the context of loss compensation and operator guarantees. The hurdle could be formed by a fixed indexed amount or the achievement of performance measures.

The last and most frequently named setting was the subordinated fee payment. Due to owner's or bank's priority their financial claim has to be paid before the operator receives a fee payment. The owner's priority would be a minimum interest return, which is normally agreed as a ROI. The bank's priority is similar, here the interest of the bank for borrowed capital would set the priority amount.

The hurdle and subordination for fee payment may be exerted either to the incentive or the base fee, whereby the hurdle and subordination for incentive payments was more often mentioned. One expert also mentioned, that the hurdled and subordinated fee payments form an incentive for the operator and therefore aligns the interests of both parties.

Two experts emphasised in this context, that the determination and calculation of the GOP is a very important issue in negotiations, which requires extra attention in the contractual framework. An example calculation should be attached, for an unambiguous and indisputable determination of incentive fee payments.

Additionally the possibility of fully aligning the fee payments to the overall goal of the owner, by forgoing the base fee was discussed. The experts were united in their opinion, that remuneration via an incentive fee only would only be possible in theory. A few experts have already seen this in practice, but only under exceptional circumstances. For example, if the property and location had an extraordinary strategic and promising value for the operator. Instead the experts identified a tendency for the base fee being lowered to the benefit of a higher proportion and also scaled incentive payments. This would only occur starting from the premise of a high negotiation power of the owner or if concessions were made in other areas.

The second part of remuneration is the system reimbursement. The experts unanimously were of the opinion that a mixture of payment methods is used for system overheads. These were only relevant for operators offering these services and often less distinct for unbranded independent operators. The payment mode was identified as a mix of fixed sums e.g. paid for usage of brand rights, commission based e.g. usage of reservations systems, revenue based e.g. reimbursements for marketing activities and market price based payments for singular services, e.g. IT-service, personnel administration. A bigger issue than the payment mode was the lack of transparency and appropriateness of system reimbursements. Seven experts emphasised that operators nowadays generate a large share of their profit via the reimbursements for centralized services. As the big variety of different deductions of operational costs make it hard to reconstruct the adequacy of calculations, separate service agreements are negotiated. Experts also mentioned the idea of only allowing operators to deduct market-based prices for the overhead services, to ensure a benefit for the individual hotel.

Interpretation of Findings

The fee structure was one of the issues frequently mentioned by the experts in an introducing explorative question about the most prominent areas of negotiation of today's management agreements. As the question about current issues and important negotiation points was phrased very widely, these issues can be interpreted as important and therefore significant for the contract negotiations. Sub-textual the interviews implied that the negotiation of the fee structure is one of the most frequently used factors for adjusting the risk-compensation-balance for both parties. Therefore its significance for uncertainty reduction may be rated as high.

It is noticeable that all calculation methods sketched by the experts are held variable to the market and therefore flexible to external uncertainties. They are all percentage based and adjust to the business situation of the hotel. A fixed payment will only be chosen, if the environment requires it. Meaning, a combination of an external environment, which is being perceived as very uncertain and an operator with a high negotiation power.

The experts confirmed that system reimbursements are mainly paid variable. It is interesting that the payments will mainly be paid upon usage and will not supersede the regular market price. This also keeps the reimbursements variable to market conditions. The orientation to market prices helps to reduce the internal uncertainty of hidden action, which would have the effect of overvalued reimbursement payments to the operator's headquarters and additionally help to adapt to external uncertainties.

The assumption, that the remuneration in general is kept variable to the market and business conditions, can therefore be confirmed (SH1). Thereby the remuneration is normally not only paid commission-based, but as a mixture of fixed, commission-based or upon market prices, depending on the costs applied. Also the transactional effect of cost allocation may play a role on the payment base.

In addition to the flexibilisation of remuneration the interviewees sketched further reactions to uncertainty. While the variability of the payments adjusts to external uncertainties, the adjustments to the calculation methods aim to reduce internal uncertainties by transferring risks from the owner to the operator. Especially the occur-

rence of subordinated base fees and scaled fee payments approves this. The subordination of the base fee reduces the security for the operator immensely, as in bad years he will risk to not receive any compensation at all. Also the scaled compensation, staggered to the development of the hotel, keeps the compensation for the operator at a minimum for the first years. Here the constellation would in general be contingent by the negotiation power from both sides, whereby a tendency towards a risk sharing subordination of the fees can be seen, incentivising performance and securing owner's and bank's returns. Contrary to a flexibilisation, these adaptations to compensation increase an owner-driven safeguard of the agreement.

By a shift towards a higher share of incentive fee payments, the owner-driven safeguarding is further increased. All participants were of the opinion that an incentive payment alone would only rarely be negotiated and only if the perceived uncertainty for the operator is rated low. This could for example be in very desirable or strategically important locations. Instead the experts confirmed a tendency that both parties may use a higher percentage of incentive payments and therefore reduce the base fee, thereby gaining a balanced share of risks. They emphasised this would only take place, if the owner has a high negotiation power.

These safeguarding adaptations depend very much on the perceived uncertainty and negotiation power of the parties. If the perceived uncertainty for the operator is low, he will be willing to take over more risks through a shift towards the incentive fee, hurdled, scaled or subordinated fees throughout to a hurdled and subordinated base fee. It was also interesting to note that most experts only specified the calculation methods in the context of operator guarantees. This shows, how fee payments and the calculation method have exceeded the plain remuneration of services and have evolved to a risk balancing, uncertainty reducing and loss-compensating feature.

Termination

As the experts had various possibilities and a lot of issues to bring forward, termination was the dimension discussed the longest throughout the interviews. Three main dimensions in the context of termination could be identified. These are termination without cause, termination upon sale and termination upon bad performance of the other party.

Display of Interview Results concerning Termination without Cause

The experts were first asked about the options, either party has, to terminate the agreements without a prior breach of agreement, but caused by external changes of the environment, altered interests of a party etc. All participants stated that in general the parties cannot terminate without reason. The only possibility is a mutual agreement on termination by both parties.

The experts were of the opinion, that it would not be in the operator's interest to terminate the agreement. The base fee calculated as a percentage of revenue, was named as one reason that operators do not need a safeguard for termination. One expert explained this by saying, even if the operator does nothing or a minimum, a certain revenue will be generated, from which the operator will profit. Experts stated that a clause concerning force majeure tends to be included more often. It regulates an extraordinary termination right, if force majeure occurs with the result that the hotel business can no longer be run.

Similar rules are constructed for the owner. The experts agreed that the owner would not be able to terminate for reasons, which are beyond the control of the operator. If the owner terminates the contract regardless, he would have to pay a penalty for breach of contract. The size of the penalty often had to be decided in court or by arbitration. This showed that a termination is always possible, but substantial cost may be involved. Some experts indicated that the penalty payments for contract breaches are nowadays more often integrated and detailed in the management agreement. One expert also mentioned in this context that a termination at a low point of economy or other bad market conditions is not favourable, as the owner will have major difficulties selling the property, especially as the German hotel property market is rather small. This could be illustrated with different examples from the German hotel property market.

Display of Interview Results Concerning Termination upon Sale

The second area to be considered, when analysing the termination possibilities, is the ability of transacting the property. In a jurisdictional view a sale of the property is always possible. The deciding factors are the underlying circumstances. The sale of the property changes the subject matter of the contract and therefore requires the approval of the operator or otherwise would count as a breach of the agreement. Without any contractual regulations concerning the sale of the property, the abovementioned payments for breach of contract are applicable and the management agreement would be terminated. These legal regulations were pointed out by one of the lawyers, whereby his statement was contradicted by a few consultants, who quoted the German law concerning lease contracts, which says "sale does not breach rent" (Kauf bricht Miete nicht). To regulate misperceptions the interviewees all indicated the interest of all parties to regulate the conditions for the sale of the property already in the management agreement. The experts stated different constellations. These are easements, rights of first refusal or first offer, termination and exclusion of competitors, ill-reputes and companies, which are imposed to an embargo.

Easement[1] is a highly discussed issue in management agreements especially in Germany. Eight experts raised this subject upon the question, whether the owner is able to sell the property. It gives the operator a right in rem on the hotel property even if a change of ownership occurs or other circumstances would inhibit the forgoing of the management by the operator. The representative of the bank stated that this is in general not a negative aspect, as the bank itself has an interest in upholding business with the operator, if e.g. foreclosure is initiated and the bank becomes the owner of the property. But the penalty payments, which are included in the easements, cause some difficulties: If the right for the operating firm to manage the hotel property, irrespective of it's ownership is breached, a penalty is payable. This penalty payment reduces the amount the bank is able to issue as a mortgage bond. The penalty payment therefore reduces the value of the loan for the bank. Additionally the constellation needs to fulfil the requirements of the Association of German Pfandbrief Banks (vdp), in order to be issued as mortgage bonds. This would have a crucial impact on the profitability of the loan for the bank and the interest payable for the owner. Another reason for the tough negotiations of the easement mentioned, is the increased difficulty to transact the property. The new owner will have to bear the old operator or will have to include the penalty payment in his purchase price, which could make the deal uneconomic. The experts were not quite clear about the effect of an operator being bound to the property upon sale. Two indicated this as an advantage, as the new owner would benefit from an operator already established and accustomed with the business same as having negotiated the principle contract content of the management agreement already. On the other hand one expert affirmed that the sale would achieve higher yields for the owner without an operator installed.

A typical approach for regulating the sale of the property is the right of first refusal, which is a pre-emption right, but for an already existing property. Here the operator has the right to buy the property, if he offers at least the same as another buyer. This was mentioned as a common approach by six (50%) experts. Furthermore they sketched the problems accompanying this arrangement. Selling the property is excessively harder with a pre-emption right in place. Prospective investors are reluctant to invest time and costs in negotiating a contract, which after conclusion has to be first offered to the operator. He can accept and take over this contract without having to negotiate and would thereby tear down the deal of the third party investor. To solve this problem one expert indicated a new trend and possibility of only giving operators the right of making a first offer ex ante to third party negotiations instead of a first refusal right destroying the negotiations ex post.

The last area of consideration, when selling the hotel property, is the extraordinary termination right, applicable if the hotel is sold to competitors, ill-reputes or companies which are imposed to an embargo. All except three experts (who did not mention the issue or have no experience in this area) indicated this right. One of the participants mentioned the difficulty of defining ill-reputes and competitors. It is for example not clear, whether Blackstone being an investor in varied portfolios of different hotel real estates, but still owned by Hilton would count as a competitor. One expert stated that the exclusion of companies being on the embargo-list of e.g. U.S.A theoretically looks limiting to the sale of the property, whereby in reality this clause is not as severe. The reason is that the current owner, banks etc. involved in the sale, would themselves not risk to do business with these ill-reputes and would therefore preclude them during their due diligence. If a contract is concluded with a competitor, ill-repute or company on the embargo-list, the operator would often have the option to terminate the agreement.

Display of Interview Results Concerning Termination upon Bad Performance

The third dimension needed to be considered when analysing termination rights of management agreements is the termination upon bad performance of one of the parties. For the operator this means, that a termination right would be included, if the owner cannot pay the fees, bring in the required cash or other breaches of his obligations. Few experts emphasised these points, but three indicated this as a common clause. Termination rights for the owner are more complicated. A seemingly common and nowadays frequently used approach is the inclusion of a performance termination clause. All experts confirmed this. Three experts however limited the application of performance tests, as they stated that GOP guarantees were still common in German agreements and would therefore replace the performance tests in the respective contract. One expert stated that the inclusion of a performance termination would depend on the negotiating power of the owner. If he is in a weak position, this clause would possibly also be omitted. On the other hand, the representative of the bank emphasised, that they check, whether termination possibilities could be included, before granting financing to the owner.

Performance tests are usually coupled with variable performance measures. A mixed method of the competitive set and budget tests was named most frequently. The first compares the RevPAR of a determined set of competitors with the RevPAR of the hotel. For the budget test, the scale is drawn from the annual budget prepared by the operator and approved by the owner. The operator will fail the test, if he falls short from the budget and the competitive set by more than for exam-

[1] An easement is a certain right to use a real property without possessing it. According to German law a property can be hypothecated in such a way that the person in whose favor the hypothecate is applied, is entitled to use the property in certain dealings, or he is entitled to any other permission which can form the content of an easement („Grunddienstbarkeit“ directly translated from BGB § 1090 (1))

ple 80%. Other performance measures were singularly mentioned by the experts. These were the lone application of a competitive set or a budget test. Also a fixed indexed GOP, which has to be met, was indicated, which is fairly similar to a GOP guarantee. A termination right combined with a GOP guarantee of the operator was also indicated. Also a revenue based performance test, which was only named once.

The experts were united in their opinion that the termination right would only apply, if the performance tests were failed several years in a row (2-3 years) and often curing possibilities are included. But the number of years during which an operator would be allowed to cure the short fall would normally be limited.

Several experts indicated the execution of the termination right upon failed performance tests as being problematic. They said that the performance measures are often either defined too vague or too basic, so that they will mostly be met. Or the calculations for performance measures are too complicated and ambiguous leading to extensive lawsuits until a verdict is rendered. They said that sophisticated definitions and determinations of performance measures are important and are evolving constantly. Additionally one expert specified that failure of performance tests due to force majeure will also often break the termination right. The specification of force majeure may be very different due to the culture and originating country of the owner or operator. In Germany in general force majeure would mean not man-made disasters, like a flood, earthquakes or similar. In other cultures even an influenza could be declared as force majeure and would therefore compensate the failure of a performance test. The experts therefore considered a clear definition of force majeure an important part of management agreements.

Interpretation of Findings

Termination issues were expected to have a major impact on the flexibility of today's management agreements. This was also reflected in the statements from the experts, who frequently named termination conditions as an important issue discussed in negotiations of management agreements. The findings in the interviews supported the sub-hypothesis (SH2) assuming an increase in termination rights upon bad performance of the operator. The experts were united in their views, that performance termination rights are included commonly in German management agreements.

The second sub-hypothesis (SH3), which postulates that performance measures are variable to market conditions, was also supported by the experts. Additionally insights were gained about the constellation of performance measures. In literature mainly either a RevPAR or a budget test were quoted. A tendency is seen for the German market that a combination of the RevPAR test of a competitive set and a budget test are conducted. Although these performance measures and termination rights theoretically and on a contractual basis enhance flexibility for the owner, several experts indicated that the execution of the termination right upon bad performance is only very rarely possible. The reasons are that the performance tests are too easily met and curing possibilities attenuate the termination right even further. Therefore, the sub-hypothesis may be confirmed, but the application of the clauses are nevertheless mitigating the flexibilising effect of this termination right, to the benefit of a higher safeguard for the operator. For a future development the participants predicted that performance measures will have to be defined much more sophisticated, for the owner to really gain an effective power.

One indicator for a higher flexibility in management agreements was the integration of flexible termination rights also for the operator. This sub-hypothesis (SH4) was disproved by the statements of the interviewees, who did not perceive termination rights for the operator as relevant. They shared the opinion that operators would not aim for flexibility of the termination. Despite these expert statements, the operator has fought for flexibility in his reactions upon sale, whereby the flexibility of transacting the property is reduced for the owner. The right of first refusal was confirmed as being status quo in German management agreements. A possible trend towards transforming the first refusal right into a right of first offer, in order to enhance the transaction possibilities and therefore increase flexibility for the owner, was indicated by one participant.

To the contrary of increasing flexibility in the parties' relationship, the experts assessed the integration of easements as very typical for the German market. This is a tool for operators to further safeguard themselves from a termination of the management assignment. The easement also restricts the flexibility of sale for the owner, on the one hand by aggravating the negotiation with potential buyers and on the other by impairing financing possibilities.

These arrangements were found especially in the context of sale of the property. In the introducing questions two experts named the possibility to transact the property as a particularly important issue. This was sub-textual also reflected in the other interviews. A trend towards clarifying conditions of sale was identified, which could be rated as a reduction of flexibility, due to enhancing the completeness of the contractual framework.

As the termination upon bad performance focuses on the encounter of internal uncertainties, the termination upon sale aims at internal and external uncertainties. Furthermore the third area of termination, termination without cause, also aims at external uncertainties. Here the owner or operator would have the possibility to freely terminate the agreement. This also applies, if the other party is performing accordingly. The experts stated that normally no termination without cause would be

integrated into the management agreements. Some could see a trend though, that penalties for breach of the contract would be included in order to reduce costs caused by dispute resolution. The definition of penalty payments indirectly reduces flexibility for either side. This is due to the assumption that incomplete contracts enhance flexibility. The inclusion and negotiation of penalty payments further narrows the possibilities for interpretation of the contract. Though the integration of penalty payments has an uncertainty reducing effect, due to the information leverage, it transfers the uncertainty issue of termination costs to a computable risk for either side. The penalty payments show a tendency of operators further safeguarding the relationship.

To summarize the information gained on the flexibilisation of termination rights, a certain degree of mainly owner-driven flexibilisation could be identified. On the other hand, an operator-driven safeguarding could be seen. The inclusion of the according right will again depend on the negotiation power of either party. A strong operator will try to prevent termination rights for the owner, whereas a strong owner would try to forgo an easement.

Loss Compensation

The last area of consideration covers arrangements getting effective, if losses or insufficient profits occur. All experts agreed that today's management agreements inherit some kind of operator guarantee, which is however negotiated in different ways. Six interviewees (n=12) stated that a plain GOP guarantee will very rarely be stipulated in today's management agreements. Five experts stated that guarantees are a regular condition. One participant specified that GOP guarantees are more often found in agreements for newly built hotels, which therefore do not present a history of figures to use as a base.

Most frequently named were the fee subordinations (8 experts of n=12). The subordination can either be applied to the incentive fee, which was specified more commonly (5 experts). A few experts also mentioned the subordination being applied to the base fee (2 experts). The plain GOP guarantee in which the operator has to make sure that the owner receives a certain cash flow, irrespective whether this is generated by the operational cash flow during the period of assessment, was named by five experts. Three interviewees reported that guarantees are often limited to the initiation phase of the hotel. The reason being, that the ramp-up phase of a hotel business may endanger the ability of the owner to fulfil his interest payments to the bank. After the initiation phase the guarantee may again be given by a fee subordination etc. Interestingly four experts indicated that there is an increasing tendency to give guarantees or guarantee-like securities, instead of declining, as literature assumed. This was argued with the risk aversion of German investors and banks, the German evolution of dual management concepts from the lease mode and therefore hybrid constellations converging the management agreement and lease mode. This takes place by involving higher securities for the owner and a bigger share of risk for the operator.

The question, whether claw back provisions are often included in the agreements, was confirmed by six experts. They specified pay back of the deferred incentives in the following years, but only if the GOP supersedes the owner's priority. It may also be limited to e.g. 30% of the overrun. The result is that yields for the owner will not be limited for several years. This leaves the question open for negotiations, whether the deferred incentives will be paid back after a termination upon bad performance. Four experts negated this question and two did not have an opinion or any experience. One of the interviewees contradicted the existence of claw back provisions in German agreements and stated that this arrangement is a very American procedure.

Subsequently the interviewer asked, whether a CAP clause would be negotiated, if a guarantee is in place. All experts were agreed that in this case a CAP clause would be included. They reasoned it with the problems of balancing unlimited guarantee liabilities in the balance sheet of the operator, as he has to form a balance sheet item, covering future obligations. Furthermore, the CAP clause prevents operators from slowly loosing substance.

Interpretation of Findings

One indicator for higher flexibility in the contractual framework was to waive operator guarantees (SH 5). While the expert statements indicated a reduction of plain GOP guarantees, the general inclusion of guarantees was affirmed. The configuration of the guarantees changed and thereby added to operator flexibility. Operators have fewer restraints accounting fixed GOP guarantees in their balance sheet. The new evolution of fee subordinations and the limitation of guarantees to the initiation phase of the agreement enhance the consistency with the operator's goals and reduce the negotiation power an operator would possibly gain through GOP guarantees. This development of guarantee-like arrangements has an indirect effect on flexibility as curing and claw back provisions are less important and negotiation power is not transferred as massively, as it would with a guarantee inclusion. Nonetheless a real tendency of reducing guarantees could not be confirmed by the recorded data. Even more so experts indicated that especially in the German market, due to the historical evolution from the lease arrangements and risk aversion of German investors, the stipulation of GOP guarantees is remaining present. The uncertainty reducing effect of the new guarantee and guarantee-like arrangements have to therefore instead be interpreted as safeguarding and risk-sharing tools for the owner. The last sub-hypothesis (SH 6) indicates a safeguard for the operator, but also a flexibilising effect for both parties, due to termination options after the consumption of the

CAP reserve. This arrangement was also confirmed by the participants, as being a common tool accompanying guarantee arrangements. Additionally to the CAP clause, the participants in general confirmed the inclusion of claw back clauses. These have, instead of flexibilising a safeguarding effect for the operator. And would therefore only be included if the operator has a certain negotiation power.

Concluding, instead of making the relationship more flexible, loss compensation serves as further safeguard. As may be expected both parties try to shift the impacts of external uncertainties to the other party and try to safeguard against ramifications of internal uncertainties. This aspect requires special weighting, as experts stated guarantees and guarantee-like arrangements as one of the most important issues in negotiations.

Comprehensive Interpretation of Findings

The evaluation of expert statements concerning the hypotheses is summarized in table 3.

Table 3: Evidence for Hypothesis and Sub-Hypotheses

No.	Statement	Findings	Confirmation/ Disproof
SH1	Predominance of percentage- and commission-based remuneration	Fee payments in general commission based, not all reimbursements commission-based, but mixture of fixed components, variable and market price charge.	Confirmed
SH2	EXIT-clauses increase	Increase of performance terminations, but possibilities of executing the right is limited.	Confirmed, but flexibilising effect limited
SH3	Performance measures are adaptable to market	Confirmed by mixed application of competitive sets and budget tests.	Confirmed
SH4	Termination options upon sale for operator	Partly confirmed flexibilisation for operator, by first offer and first refusal options, and other requirements for transactions. But no termination options included, instead safeguarded by easements.	Disproven
SH5	Guarantees seldom stipulated	Disconfirmed by experts. Fewer restraining constellations for operators evolved.	Disproven
SH6	CAP-clause is integrated	Experts confirmed integration of cap clauses, mainly reasoned with safeguarding the operator.	Confirmed, but aiming at safeguarding instead of flexibilisation
H	Flexibility increase in contractual framework	Mainly in area of remuneration and termination flexibilisation is enhanced. Mainly owner-driven. No full confirmation possible.	Disconfirmed, apart from termination area

Next to the arrangements included in the sub-hypotheses further circumstances indicated by the experts disprove the overall hypothesis. These are the calculation methods for fee payment, which aim at the balance of risk instead of flexibilisation; the missing feasibility of executing performance terminations; the inclusion of easements and rights of first refusal, which amongst other issues restrict the transaction possibilities; and the increase of guarantee-like arrangements, enhancing risk-sharing.

The displayed adaptations were indicated by the experts as being common in German management agreements. This does not exclude other possible configurations of contracts and arrangements.

Additionally a trend towards more clearly defined responsibilities could be determined. Where flexibilisation could be identified, it was mainly owner-driven. Instead of flexibilisation several new clauses and adaptations indicated safeguarding effects. These were mostly operator-driven, but e.g. regarding loss compensation also owner-driven. The following reasons for a lower rate of flexibilisation were identified:

- perceived risk aversion of German investors,
- remaining high negotiation power of the operators,
- increased knowledge base of owners,
- no existence of a higher and fire culture and
- low perceived uncertainty of the German hotel real estate market.

The analysis and interpretation of the expert statements imply that the adaptations of management agreements are very much dependent on the negotiation power of the parties, instead of directly occurring from uncertainty perceptions. All experts emphasised the negotiation power being most influential on the constellations of management agreements. Thus no distinct constellation of management agreements in Germany can be defined. Thereby one party will be able to include more advantageous clauses dependent on the negotiation power towards the other party. Two situations can be identified as being especially influential for the contract constellation. For Situation A, a high negotiation power of the owner would be prevalent over a low negotiation power of the operator. An owner will gain a high negotiation power, if the location, property, strategic impact of the hotel business and prospects of a successful business are high. Therefore the external uncertainties will be perceived as low. Furthermore the experts implied that the owner would have a high negotiation power, if he is experienced and has know-how about the hotel business, thus implying a perceived low internal uncertainty for the operator. On the contrary, Situation B assumes a low negotiation power for the owner and a high negotia-

tion power for the operator. The owner's power will be assessed as low, if the location, property and prospect of business success are evaluated unfavourable, resulting in a higher perceived external uncertainty. Also the characteristics of the operator would imply a lower internal uncertainty, e.g. by signalling success through a brand, compared to independent operators.

These two classical uncertainty situations, revealing the power balance of the two parties, may be drawn from the results of the study. Table 4 shows, which adaptations could be expected for a certain power balance of the two parties.

Table 4 Promoted Adaptations to Management Agreements According to Negotiation Power and Uncertainty Situation

Situation A (“Strong Owner”)	**Situation B (“Strong Operator”)**
Shift towards incentive fee	High base fee share, generally high fee payment
Subordinated, hurdled incentive or even base fee payments	Plain percentage based fee payments, without guarantee-like arrangements
Strong performance measures Inclusion of performance termination right	Weak performance measures
Right of first offer upon sale	Right of first refusal upon sale Exclusion of competitors, ill-reputes and embargo imposed buyers Inclusion of an easement
Inclusion of a GOP guarantee, or strong guarantee-like arrangements	No guarantees or guarantee-like arrangements Inclusion of a claw back provision Inclusion of a CAP clause

Assumptions Situation A		**Assumptions Situation B**	
Negotiation Power Operator	low	Negotiation Power Operator	high
Negotiation Power Owner	high	Negotiation Power Owner	low
Perceived External Uncertainty	low	Perceived External Uncertainty	high
Perceived Internal Uncertainty for Operator	low	Perceived Internal Uncertainty for Owner	low

5. CONCLUSIONS

The overall objective of the paper at hand was to analyze the adaptations made to management agreements in Germany due to uncertainty factors. The overall hypothesis assuming a flexibilisation of the German management agreements could not be fully confirmed by the three examined areas of management agreements. Some tendencies of flexibilisation could be identified. These are the variable remuneration, inclusion of performance tests and variable performance measures. Adaptations restraining flexibility were also identified. These are the evolved calculation methods for fee payments, enhanced risk sharing, feasibility of executing performance terminations, easements restraining the sale possibility, and owner-driven safeguarding of returns by transferring the risk of losses to the operator.

The assumed flexibilisation could not be confirmed fully instead new knowledge about current adaptations was found and evaluated with regards to their uncertainty impact. Additionally derived from the empirical data, two contrary situations of uncertainty and power balance of the two parties were defined. Clauses probable or suitable for either situation were allocated. The sample conducted gave a broad insight into the possible constellations and developments in the German market. As the research has revealed that next to the uncertainty perception, the negotiation power has a particular impact on the contract design, it gives further implications for future research. A conduction of a segmented sample displaying different uncertainty configurations and different power distributions, as implied in the paper at hand, could reveal further knowledge about the favorable and probable contract constellations according to different circumstances. The factors and adaptations displayed in this paper could be further analyzed in their impact to the profit and risk relation for the parties. A future constitutive study is suggested, displaying the status quo of management agreements in Germany would reveal further indications for trends and developments and would allow a longitudinal analysis. Last also displaying the results of the study concerning duration, participation and capital provision would give an even broader view upon the design of management agreements.

Operators and owners in a management relationship or those, who are assessing whether to enter a management agreement and those, who are in the process of negotiating the contractual framework, consultants, lawyers and bankers being specialized in management agreements and further interested parties may gain from the research displayed.

Especially in the areas of performance measures, and rights of first offer compared to first refusal a need for improvement was revealed. Additionally several variations of safeguarding and aligning the goals of both

parties were assessed, e.g. the inclusion of guarantee-like arrangements.

The paper at hand can guide interest groups through the possible design of management agreements concerning remuneration, termination and loss compensation and give support in finding the optimal balance of risk sharing and profit potentials while considering internal and external uncertainty factors.

6. ABOUT THE AUTHOR

Natalie Audrey Balch, MBA has gained experience in the hospitality industry working in hotels in Germany and Egypt prior to and during her studies of business administration focusing on hospitality management at the Baden-Wuerttemberg Cooperative State University (DHBW) Ravensburg. After completion of her undergraduate studies, she worked for the DHBW Ravensburg as department assistant and currently as department manager for Business Administration with Tourism and Hospitality Management VI, where she has multiple contact points with the current issues discussed in hospitality practice. In the meantime she graduated part-time with a Master of Business Administration focusing on International Business Management and Leadership at the University of Applied Science in Kempten.

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