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Boards Working Harder

HVS Executive Search annual review of corporate governance practices at European hotel companies

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Boards Working Harder

2009 was not an easy year for anyone. Across Europe, the hotel industry saw operators slashing room rates and desperately trying to replace the sudden absence of corporate demand with leisure guests. New supply was still entering the market and major currency fluctuations added to the complexity of the problem. Challenges aside, hotel companies learned how to re-focus on some of the fundamentals of the business: controlling and containing costs and expenses. Some companies went through major restructurings and others saw the weakness of their competitors as a chance to grow their market share. Being able to steer a company through an ever-changing business environment with certainty and confidence is a vital key to success; and it is the board of directors' responsibility to oversee the strategies which provide the direction for the company. Sound corporate governance is, now more than ever, of utmost importance.

HVS EUROPEAN CORPORATE GOVERNANCE STUDY

HVS Executive Search reviewed 21 publicly listed European hotel companies. Studying the firms' annual reports and, where necessary, conducting interviews, the companies were scored on their performance in four key categories:

- Size, makeup and independence of the board
- Committee structure and effectiveness
- Presence of interlocks, insider participation and related transactions
- Commitment to pay-for-performance for executives and director pay.

These categories are widely accepted as the main building blocks of sound corporate governance policies. Yet, given regional particularities and varying regulations within the European market place, merely checking for compliance with a predefined set of rules would be inadequate. Instead, and more significantly, it is a question of identifying which policies should be in place and which practices should be dropped.

This year, we have, for example, only rewarded companies for having a Senior Independent Director if their Chairman is also the CEO or an insider. In all other instances (where the Chairman does not have any ties to the company other than sitting on its board), the role of the Senior Independent Director appears redundant – an independent Chairman could in fact equally perform the role of reviewing the performance of the board.

Taking this into account, it is encouraging to note that only 24% of the companies do not comply with this requirement.

Some companies (such as Accor) have reversed the separation of the roles of Chairman and CEO. These companies run the risk of board meeting agendas being influenced in such a way that sensitive subjects which may question his/her leadership may not be addressed. In an ideal scenario, the two positions should be independent from each other. However, there are now eight companies in the sample group where this is not the case. Also, the number of Chairmen who are insiders has gone up to almost two-thirds, an increase of 10%-points from last year.

	COMPANY	SIZE & MAKEUP	COMMITTEE STRUCTURE	INTERLOCKS & INSIDER PARTICIPATION	PAY FOR PERFORMANCE	TOTAL
1	Whitbread	91%	75%	100%	100%	91%
2	Rezidor Hotel Group	91%	83%	100%	80%	89%
3	InterContinental Hotels Group	64%	92%	100%	80%	84%
4	Euro Disney	91%	42%	100%	100%	83%
5	Accor Corporation	36%	92%	100%	100%	82%
6	TUI Hotels	45%	75%	100%	100%	80%
7	MWB - Malmaison	64%	67%	100%	80%	78%
8	Club Méditerranée	73%	83%	50%	100%	77%
9	NH Hoteles	36%	83%	50%	100%	67%
10	Fuller, Smith & Turner	27%	75%	100%	60%	66%
=11	Societe Des Bains De Mer	55%	83%	100%	20%	64%
=11	Millennium & Copthorne Hotels	82%	83%	50%	40%	64%
=11	Peel Hotels	36%	58%	100%	60%	64%
=12	Pierre & Vacances	64%	50%	100%	40%	63%
=12	Sonae Capital	55%	58%	100%	40%	63%
=12	Orco Property Group	45%	67%	100%	40%	63%
13	International Hotel Investments	55%	50%	100%	40%	61%
=14	Park Plaza Hotels	45%	75%	100%	20%	60%
=14	Maypole Group	91%	8%	100%	40%	60%
15	Danubius Hotels	55%	58%	100%	20%	58%
16	Sol Meliá Hotels & Resorts	27%	92%	50%	60%	57%

BOARD SIZE & MAKEUP

The board of directors is at the centre of the corporate governance system. To be effective, it is vital that the board can assess and quickly respond to changes in the business environment. An uneven number of group members facilitates the decision-making process and is therefore preferable to an even number. Similarly, too large a group can complicate matters. Experts therefore suggest anything between five and 11 group members.

Only five out of the 21 companies had above the recommended number of board members.

Only five out of the 21 companies were above the recommended threshold, but nine had an even number of board members. 24% of the surveyed companies had an equal split between independent and dependent board members; in 48% of the firms, independent directors held the majority of the voting rights. Generally speaking, a board which is predominantly made up of independent directors is more likely to perform its function as the guardian of shareholder interests. Dependent directors can provide valuable information about the company's activities and operations – yet, they are aligned with the CEO and their assessments are more likely to favour the management. It is for these reasons that executive directors should not dominate a board.

The great majority of companies (76%) re-elect their board members at least once every three years; the average length of term lies at 2.9 years. Ideally, however, this figure should be much closer to one year as this would allow for corrective actions should the performance of an individual board member not stand up to expectations.

Within this first category, four companies almost achieved top scores: Euro Disney, Maypole, The Rezidor Hotel Group and Whitbread.

COMMITTEE STRUCTURE

Experts suggest that the board of directors sets up three committees:

- Audit
- Remuneration
- Nomination

This structure empowers the board to effectively assess strategic decisions, review financial performance and executive compensation. It also facilitates the board to exert control over the direction of the company by approving, or not, nominations to the board. Some boards may also include a Corporate Governance committee. However, we are seeing that more often these duties are handled by the Nomination committee.

Within this category, points were allocated for the composition of each committee, taking into account whether or not a committee includes an insider and the number of times it met.

- On average, the board of directors met seven times, median attendance rate was 92%.
- 57% of audit committees met at least once every quarter. The figure remains unchanged compared to last year's report but should ideally be higher.
- Compared to the previous year, executive compensation was reviewed more often with 52% of the remuneration committees meeting more than twice per year. By contrast, during the boom of 2007, only 26% of the companies met three times or more.
- Nomination committees met on average 2.2 times during 2009. A notable increase of 40% compared to 2008.

It therefore appears that in the past year there were more meetings taking place to address critical issues around the areas of remuneration and nomination. The global financial crisis has evidently increased the workload of the board of directors.

Top performers within this category were Accor, IHG and Sol Meliá. Overall, companies fared much better in this category and compared to last year there was an improvement of 6%-points in the average score (69%).

INTERLOCKS & INSIDER PARTICIPATION

For several years, board interlocks (I'll sit on your board and you sit on mine) have not been an issue with the major European publicly listed hotel companies. It appears that the old days when social ties, business relationships and/or common backgrounds represented an entry ticket to the controlling bodies of the world's leading (hotel) companies have gone.

Insider participation, which occurs when a board member (or a firm in which s/he is a major shareholder) engages in business activities with the company, is less obvious to the public. It could lead to unfavourable business deals for the company's shareholders and should be avoided at all cost. Companies that still engage in insider deals have clearly stated so in their annual reports. For the sake of the shareholder however, it would be desirable to divulge further details on such business deals and we have therefore been stricter with the allocation of points to these companies.

PAY-FOR-PERFORMANCE

As one can tell from the number of times the individual remuneration committees had met, executive pay continues to be a hot topic.

In the past, shareholders were fighting the agency problem – the best way to do this was by setting up and implementing long-term incentives and stock options, to be exercised at some point in the future (basically ensuring executive commitment to sustainable and continued growth).

Nowadays, however, the great majority of companies have such systems in place. When assessing pay-for-performance practices it has now become a more detailed analysis; for example assessing strike prices at which stock options are granted, or identifying any unsubstantiated or above average increases in an individual's compensation package compared to others.

Transparency of information is therefore especially key to a fair assessment. The study has consequently been more stringent on companies which were less open in disclosing compensation details (whilst respecting regional differences with regard to the reporting requirements).

Maximum points were attributed to those companies where non-executive compensation included an annual director's fee, a membership fee for sitting (or chairing) a committee, as well as a shareholding.

Compared to 2008, more companies achieved top scores in non-executive compensation (33% versus 29%). Also, average score in both executive and non-executive performance increased by 6%-points to 63%. Top marks were achieved by French companies Accor, Club Méditerranée and Euro Disney, as well as Whitbread, Tui and NH Hotels. Close runner ups were The Rezidor Hotel Group, IHG and MWB.

RESULTS

For a third year in a row, the same three companies have dominated the top of our scoring. In first place in the 2009 HVS Corporate Governance study came Whitbread, achieving a commendable 91% (up by 7%-points). Last year's winner, The Rezidor Hotel Group, achieved a very respectable second place (89%, up 3%-points) and was followed by the InterContinental Hotels Group (84%, down 1%-point).

Given the change in CEO, who also holds the position of Chairman, Accor dropped to fifth place (at 82%, down from 84% and joint third place last year). Notable improvements were achieved by MWB and Club Méditerranée, whose scores increased by 7%- and 8%-points, respectively.

It is encouraging to note that overall, and despite being stricter in allocating points, average scores increased. Management has looked to the board for more guidance and in turn boards had a more hands-on involvement in helping companies navigate through difficult times.

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Thomas Mielke is a Senior Associate at HVS Executive Search in London. Since joining the firm in 2008, Thomas has assisted clients with searches ranging in functional expertise from real estate and asset management to technical services and brand management. He is the co-author of HVS's annual European Corporate Governance Study and also helped institute HVS's annual review of CEO turnover at the 50 largest hotel companies in the world. Born in Spain and of Swiss-German origins, Thomas is fluent in German, Spanish, French and English. He graduated from Ecole hôtelière de Lausanne and holds a Bachelor of Science in International Hospitality Management with a specialisation in Resort and Leisure Development.

About HVS Executive Search

HVS Executive Search is the premier executive search and advisory firm providing human capital consulting services to leaders of the hotel, restaurant, and gaming industries. Practice areas include senior-level executive search, mid-management recruitment, compensation consulting, and performance management. HVS delivers highly customised solutions by focusing on the needs of our clients and bottom line results. Our professionals are located in New York, London, Hong Kong, Moscow, Mumbai and New Delhi and give the firm worldwide exposure our clients demand. Please visit www.hvs-executivesearch.com.

HVS Executive Search is a division of HVS, a fully integrated consulting firm focused on the hospitality industry. Founded in 1980, HVS is the world's leading specialist in hospitality consulting. With 30 offices globally, HVS offers unparalleled worldwide market expertise.

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, restaurant, shared ownership, gaming, and leisure industries. Established in 1980, the company offers a comprehensive scope of services and specialized industry expertise to help you enhance the economic returns and value of your hospitality assets.

Because hotels represent both real property and operating businesses, the founding partners of HVS decided to develop the first comprehensive valuation methodology for appraising these specialized assets. Their initial textbook on this topic entitled, The Valuation of Hotels and Motels, published by the Appraisal Institute, created the industry standard for valuing hotels and is now used by virtually every appraiser around the world. HVS continues to be at the forefront of hotel valuation methodology, having published six textbooks and hundreds of articles on this subject, which are used in appraisal courses and seminars and at leading hotel schools such as Lausanne, IMHI, and Cornell. HVS associates are constantly called upon to teach this methodology to hotel owners, lenders, and operators and to participate at industry conferences. HVS principals literally 'wrote the book' on hotel valuation, which significantly enhances the credibility and reliability of our conclusions.

Over the past three decades, HVS has expanded both its range of services and its geographical boundaries. The company's global reach, through a network of 30 offices staffed by 400 seasoned industry professionals, gives you access to an unparalleled range of complementary services for the hospitality industry:

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Property Tax Services
Convention, Sports & Entertainment Facilities
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Risk Management

Our clients include prominent hotel owners, lending institutions, international hotel companies, management entities, governmental agencies, and law and accounting firms from North America, Europe, Asia, Latin America, and the Caribbean. HVS principals are regarded as the leading professionals in their respective regions of the globe. We are client driven, entrepreneurial, and dedicated to providing the best advice and services in a timely and cost-efficient manner. HVS employees continue to be industry leaders, consistently generating a wide variety of articles, studies, and publications on all aspects of the hospitality industry.

HVS is the industry's primary source of hotel ownership data. Our 2,000+ assignments each year keep us at the forefront of trends and knowledge regarding information on financial operating results, management contracts, franchise agreements, compensation programs, financing structures, and transactions. With access to our industry intelligence and data, you will have the most timely information and the best tools available to make critical decisions about your hospitality assets.

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