Corporate ETHICS Corporate PAY AND THE LODGING INDUSTRY

A lodging industry icon lashes out at corporate malfeasance

In the spring of 2002 there was great optimism that the country was about to come out of recession and the stock market was poised to recover. Then, in rapid succession, we had the collapse of Enron and Arthur Andersen's conviction for criminal obstruction of justice for shredding Enron documents. Bernie Ebbers, CEO of WorldCom, overstated earnings by $3.8 billion, yet took a $1.5 million-a-year company pay out for life while his employees lost their jobs and shareholders lost $17 billion. Tyco's CEO was charged with tax evasion. Xerox paid a $10-million fine for overstating revenues. Merrill Lynch paid $100 million to settle charges that its analysts mislead investors.

Jack Welch, once a business school and GE corporate icon, is now a poster boy for corporate excess and vulgarity. His spurned wife revealed his $9-million annual pension plan payout, plus preposterous perks like lifetime use of GE's $80,000-per-month Manhattan apartment with free food and free maid service (he can't afford a hotel room in New York City?); lifetime use of the GE fleet of corporate jets, including a Boeing 737 business jet; a new Mercedes plus a limousine and driver (presumably to tow the Mercedes); and assorted free sports and opera box tickets. Manipulation of financial statements, reporting of exaggerated profits and perceived overcompensation of corporate executives have sent the stock market spinning downward, weakened the American dollar and eroded investor confidence in our free market system. We've all paid a price.

So far, the lodging industry has remained relatively unscathed by public scandal. There was, of course, the unfortunate merger of HFS and CUC into Cendant, where Cendant spent nearly $3 billion repairing its reputation and dealing with the consequences of the accounting fraud at CUC. Cendant Chairman Henry Silverman learned the painful lesson that the most important decisions you make in life are the partners you choose. Then there were the indictments against a pair of former owners of the Days Inn chain on 33 counts of bank fraud and tax evasion.

Ethical awareness and sensitivity are crucial components in all business decisions. Character counts. The integrity of your company is its most precious asset. To reverse the anger and the angst in America, lodging leaders and their counterparts in other industries can no longer brag "they did nothing illegal." They must also demonstrate to their boards of directors, their employees (we now call them associates), their franchisees (if they are a franchising company), hotel owners (if they are a hotel management company) and their shareholders that as responsible leaders, they possess the character, courage and integrity to condemn, privately and publicly, those practices which may be legal but are unethical or immoral in the eyes of their constituencies. Leaders who are concerned with good corporate governance should vow to bring all issues that involve moral ambiguity to their boards for discussion and resolution.

Let's look at some examples of ethical issues facing the hotel industry:
• Some franchise companies have been more aggressive than others in charging corporate overhead to off-balance sheet marketing and reservation trust funds. Every dollar of corporate overhead that can be pushed to the marketing or reservation fund increases corporate profits by a dollar. This practice improves operating margins, which wins the admiration and praise of Wall Street analysts, who then pressure other franchise companies to do the same.

Accounting for these trust funds is at the sole discretion of the franchisor. It is very difficult for a CFO looking for quarterly earnings increases not to be tempted to charge additional overhead expense to the funds to make up earnings shortfalls. Is this manipulation of earnings or a legitimate business practice?

• Another ethical issue arises in both management and franchise companies with respect to corporate hotel purchasing programs, where the intent is to use the collective purchasing power of the system to offer hotel owners and franchisees the lowest possible prices and the widest choice of vendors who can deliver the desired level of product quality. This system can become compromised when vendors, who are forced to pay huge upfront fees or a percentage of their sales as corporate kickbacks or rebates, are given preferred access in the system.

While vendors who refuse to pay these fees may be able to offer lower prices or a better product, they're excluded from corporate endorsement. Should profits from purchasing programs be used to inflate corporate earnings, or should they be shared with franchisees to lower purchasing costs?

• Another ethical question involves whether franchising companies should provide their franchisees (or at least their franchise advisory councils) with detailed, independently audited marketing and reservation statements. Full disclosure of all transactions regarding these trust funds is necessary because sunshine is a great disinfectant. Business in the sunshine prevents abuse and builds confidence and mutual trust in the integrity of these non-reported funds.

• Another ethical issue is excessive executive pay. Some would argue that Henry Silverman's $36-million pay package last year at Cendant was a bit excessive, especially compared to Bill Marriott. When Bill Marriott recognized his company was downsizing and laying off workers after Sept. 11, he canceled his annual bonus and took home a more modest $941,000 in 2001. A housekeeper making $5.25 an hour (or even $14 an hour in Manhattan) probably has a hard time justifying paying Henry Silverman $17,308 per hour.

Twenty years ago, Lee Iacocca, then chairman of Chrysler, was the highest paid corporate executive in America at $20 million per year. Since 1980, the average CEO pay has gone from 42 times to more than 400 times the pay of the average production worker.

Ethical issues are not limited to corporate offices and boardrooms. Was it ethical for the owner of a hotel in Payson, AZ to triple his normal summer room rates when a nearby area was consumed by massive forest fires and frightened families were forced to evacuate homes to avoid the flames? Does raising room rates in concert with rising demand have ethical implications?

Trust in business is not easily created, but it is easily destroyed. President Bush has asked corporate leaders for a higher standard of personal responsibility to regain the trust of the American people. Attitudes are changing and corporate CEOs and enlightened boards who claim to be "reinventing business" need to change, too.

General Norman Schwarzkopf, hero of Desert Storm, has a piece of advice that all lodging CEOs should heed. He calls it Rule 14: "When in doubt, do what's right." It doesn't get any simpler than that.

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