

## Methodological Aspects of Strategic Management of Financial Risks during Construction of Hotel Business Objects

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### Abstract

The article substantiates the actuality of strategic management of financial risks during construction of hotel business objects. Two main strategies of hotel business development are described: strategy of geographical expansion, based on the active entering the new markets by means of starting the larger number of standard hotels, and focused geographical strategy which supposes lower growth rates, as the growth is achieved by means of increasing the number of hotels with unique and first-class service and unmatched atmosphere. Financial risks are viewed in the article as many-aspect notion, depending on multiple factors of external and internal environment of a hotel enterprise. It is substantiated that formation of financial and economic model of risks management should be based on a complex approach to the analysis of the environment of organization functioning. At that, a special attention in these models should be paid to the risks related to financing of investment projects and evaluation of their cost. The authors offer and describe the strategy of hotel business development with implementation of targeted function of management – cost increase. This model allows determining the directions of hotel business cost increase and finding the main vector of development. The showed results of research supplement the existing approaches to strategic management in hotel business and stipulate the formation of methodological instrumentarium which allows minimizing financial risks during construction of hotel business objects. Implementation of well-balanced model of the structure of sources for financing hotel business enterprises will allow determining risks at the stage of construction, evaluating their significance, and developing timely measures for their minimization and liquidation.

**Keywords:** hotel business, risks, well-balanced model, strategy, construction

### 1. Introduction

One of the necessary conditions for constant growth of economy, achievement of competitiveness, and development of enterprises of construction industry in Russia is increasing the efficiency of investment activities. At that, the probability of losses from investments grows significantly with the increase of the level of expected income from investments (Kovalev, 2015).

Investment construction projects require significant financial investments, so the level of risk increases. While investing into the object of hotel sphere, it is necessary to take into account the dependence of acquiring income on ratio of demand and offer in the specific market and specific region, on the popularity of a brand, etc.

While studying investment construction projects in the hotel business, it should be noted that hotel business in Russia is one of the economy spheres which develop very quickly and successfully. Hotel market includes large companies which unite multiple brands, particular international and domestic hotel chains, and independent hotels. The Russian brands are moving up in the rankings rather slowly, but still the hotel marketing has a lot of perspectives – as more than 60% of the Russian hotels work with little-known brands (Egorov et al., 2010). Most of the hotel chains stick to the strategy of extensive growth. At the modern stage, it is possible to allocate two models of this strategy. The first one is aimed at the active and quick penetration into the new geographical markets, starting a large number of standard hotels, and formation of the branched network – this is the strategy of wide geographic expansion; it includes the hotel chains Hilton, Accor, and InterContinental (Zaitseva, 2013).

The second model of the strategy of extensive growth is characterized by lower rates of growth, as the growth is achieved by means of increasing the number of hotels with unique and first-class service and unmatched atmosphere and focused geographical strategy – these include hotels of the chains Baglioni, Kempinski, and Rocco Forte Collection. In markets with high competition, such as hotel market of Moscow, hotel chains use the strategy of acquiring new segments (Vinogradova & Larionova, 2014).

Nowadays, the Russian hotel business undergoes one of the most difficult periods – as almost any sectorial market reacts to crisis phenomena; hotel chains reconsider and make allowances into their strategies. Consequently, the issues of reconsidering the strategic priorities of hotel business remain topical. Despite the large number of studies devoted to the problems of strategic management (Nonano et al., 2005; Copeland & Murrin, 2005; Lityagin, 2010; Martin, 2006), their scientific elaboration is not full on the whole and, in particular, in the sphere of strategic management of risks as to the hotel business.

Financial risks of hotel business are different at the stages of design, construction, start, and exploitation of the hotel. Unlike the many scientific works on financial risks in hotel business, this research concentrates on the study of methodological aspects of strategic management of financial risks at the stage of design and construction of the hotel business objects, i.e., it is based on the authors' studies in hotel business and construction sphere.

## 2. Methodology

The issues of the meaning of economic risks and the reasons for their emergence and classification are viewed in the works of such foreign economists as A. Marshall, I. Schumpeter, J. Cowell, J. Pickford, P. Bernstein, and others (Parmenter, 2007; Graboviy, 1996; Popelnyukhov & Kapyrin, 2013).

Over the last years, the research in the sphere of evaluation and management of risks in various spheres of economy was conducted in the works of the following Russian scientists: A. Asaul, V. Abchuk, I. Balabanov, P. Grabovoy, K. Gumba, Y. Panibratov, S. Popelnyukhov and others (Vinogradova & Larionova, 2014; Lukasevich, 2007).

Most of the works of the Russian and foreign authors are devoted to the study of the strategies of hotel business: P. L. Ingram, O. Gilbert, Kapur, V. S. Katkalo, M. Y. Layko, A. D. Chudnovskiy and others (Martin, 2006).

Risk is a multi-aspect notion, so at present, economic literature does not provide unambiguous understanding and approach to the complex evaluation of risk in construction in view of the factors of the environment of functioning and the choice of better variant. According to K. M. Gumba (2009), the problem of construction innovational business is difficulty in choosing perspective projects, i.e., absence of universal methodology of efficiency evaluation.

The mechanism of taking managerial decisions in construction should initially provide the evaluation of possible risks, their classification as to the level of manageability and influence by the organization's managers. This allows determining the variety of risks and allowable limits of their changing which can be influenced by construction organization, as well as determining risks which should be taken into account due to impossibility to influence them. According to P. G. Grabovoy, justified or allowable risk is a necessary component of the strategy and tactics of effective management (Grabovoy, 1996).

Formation of financial and economic model of risk management should be based on the complex approach to the analysis of the environment of organization functioning. Special attention in these models should be paid to the risks related to financing investment projects and evaluation of their cost (Vasilyeva & Petrovskaya, 2010). At present, according to S. N. Popelnyukhov (Popelnyukhov & Kapyrin, 2013), effective management of aggregate risk is impossible without use of special methods of analysis and management. It is advisable to develop complex systems of analysis and management of risks which take into account the changes of informational and methodological basis, including the most effective achievements and their modifications. These systems will allow reflecting all processes of functioning of construction projects in time with necessary level of precision, determining private and aggregate risks and reasons for their appearance, forming criteria of evaluation on the basis of strategic goals, evaluating the level of influence of risks on market cost of enterprise, and choosing the best variant from their totality.

Strategic management is one of the most popular means for management. Theoretical development goes behind the practice of changes in turbulent, chaotic, and non-linear environment, which causes constant actualization of the aspects of strategic management (Royer Paul, 2000).

Classical model of strategy development includes mission formulation, strategic analysis, development of strategic goals, determination and evaluation of variants of strategic development, implementation of strategy,

and evaluation of its efficiency (Kovalev, 2006; Lityagin, 2010). Strengthening of strategic accents in management, in view of which not only the current profit but the profit of future period and the sources of its generation are evaluated (Copeland & Murrin, 2005), predetermines the substantiation of each stage of development of the strategy of development taking into account the changes of business market cost. Each stage of management is a whole complex of actions and procedures which include instruments of financial substantiation of changes in business market cost. The stage of strategic analysis includes the use of not only traditional approaches of financial analysis, expert evaluations of strong and weak financial positions of enterprise, as compared to rivals, but also evaluation of hotel business at the current period. The main task of this stage of financial substantiation of the development strategy consists not only in diagnostics of the state of hotel business at the current period but in determining the strategic position, allocating possibilities and threats for functioning in long-term, for further forecasting of future income. The complex analysis of future incomes and implementation of the strategy requires the determinants of the cost of hotel business and evaluation of the level of their mutual influence (Royer Paul, 2000). Choosing strategic alternatives consists in the evaluation of strategic decisions which ensure various changes of the cost: construction of new hotel, temporary shutdown of construction, or continuation of a project and setting into operation, which is the basis for strategy development. The strategy of hotel business, aimed at the cost increase, can be reached by evaluation, monitoring, control, and management of determinants of cost which correspond to the main elements of the model of economic value added. Evaluation of implementation of the strategy is supplemented by the system of operative indicators for account of influence of decisions, made at various levels, on the business cost.

Changes in hotel business, aimed at the growth and development of cost and investment attractiveness, can be achieved by evaluation, monitoring, control, and management of main channels of cost formation which correspond to the main elements of the model of economic value added (Smith, 1996).

The advantage of the model of economic profit consists in the fact that it characterizes the results of activities in a particular year, allows evaluation the efficiency of work of enterprise on the whole and of its departments. It is a tool for universal evaluation of business; among other things, it is used for non-public companies (which are most of hotel enterprises), being an indicator of the quality of managerial decisions and proving the increase of enterprise cost, while the opposite shows its reduction:

$$EVA = IC * (ROI - WACC) \quad (1)$$

where: EVA – economic value added

IC – invested capital;

ROI – return on investment;

WACC – weighted average cost (price, expenses) of capital.

The cost of enterprise with the use of the model of economic profit is calculated with the following formula:

$$V = f(IC, PV(EVA)) \quad (2)$$

where V – market cost of hotel business;

$PV(EVA)$  - given EVA.

One of the main problems for creation of strategy of development, oriented at the growth of market cost, is evaluation of the risk level of investor and management of financial risks. The complex system of risk management is a dynamically developing system, the strategic aim of which is provision of necessary level of market sustainability and protection of capital from negative influence of the factors of the environment of functioning (Miller & Bromiley, 2001). Such system should include the totality of interconnected sub-systems which allow performing the following processes: forecasting, rational organization and provision of activities with necessary resources, control of their use, allocation of the reasons for changing of main factors which influence the efficiency of organization's functioning, calculation of the level of their influence on the quality of resources management, and development of task-oriented measures which allow eliminating or reducing the organization's losses as a result of unfavorable influence of these reasons. The goal of each sub-system should be formed in view of the strategic goal of the complex system of risk management, which will allow conducting well-balanced approach between maximization of income and aggregate risk (Ahmed, El Rajy, Goraya, & Kausar, 2014).

Each of the described sub-systems is characterized by a certain list of factors – e.g., the sub-system of selection of sources for financing investment project should include such factors as own assets (EC), borrowed assets (DC), total ties between components of sources (R), total factors which characterize the state and structure of sources of financing  $F_{sif}$ , and total conditions, requirements, and limitations between components of sources for financing, according to the legislature and normative values for the sphere ( $Q_{sif}$ ).

This will allow setting threshold values of profitability of financing sources ( $FR1_{tsif}$ ), minimum allowed share of owners in the business ( $FR2_{tsif}$ ), and the threshold of mobility and sustainability of own assets which allows keeping control of the business in the period of formation of the structure of financing sources ( $FR3_{tsif}$ ).

A necessary condition for evaluation of the quality of the model of structure of sources for financing the innovative activities is the following limitation: cost of the source of financing the innovative activities (WACC) should be lower than profitability of invested capital ( $FR1_{sif}$ ).

In view of the above mentioned, the well-balanced model of the structure of sources for financing the innovative activities has the following form:

$$F(Sif) \rightarrow \text{MAX} \quad (3)$$

$$Sif = (EC, DC, R, F_{sif}, Q_{sif}) \quad (4)$$

$$FR1_{sif} \geq FR1_{tsif} \quad (5)$$

$$FR2_{sif} \geq FR2_{tsif} \quad (6)$$

$$FR3_{sif} \geq FR3_{tsif} \quad (7)$$

$$WACC < FR1_{sif} \quad (8)$$

The offered model can be used for formation of the sources of financing of any types of activities and will allow selecting the most optimal variant.

### 3. Results

Based on the results of the conducted research, it is possible to conclude that, despite the unfavorable geopolitical and economic situation, investors didn't lose interest to hotel market. The current situation influenced mostly the development of new projects, as the opening of four hotels with total 2,000 rooms, planned for 2014, was moved to 2015. At that, all hotels under construction are to be finished and put into operation, but the new projects, which are at initial stages, are being temporary shut down. While a while ago, hotel chains preferred to expand their presence in the cities with more than million people, now they concentrate on regional centers with population of more than 300,000 people (Zaitseva, 2013).

Let us cite the results of the survey by the analytical company EY, devoted to the tendencies of development of hotel business in Russia and current economic situation. The company questioned 65% of developers and 35% of hotel operators. The survey showed that 63% of hotel operators did not change their business strategy due to difficult geopolitical situation and sanctions pressure on the Russian economy, and only 37% of operators put freeze on their plans for development. The hotel developers also consider the current situation to be a stable one. Thus, 33% of developers think that their business is profitable, and 54% - that it is stable. At that, more than 60% of questioned operators and developers plan to optimize expenses and do business in a more efficient way. The studies of the article's authors also confirm these evaluations and tendencies.

On the basis of the conducted analysis of the situation as to construction of hotel objects, for correcting and creation of development strategy, the authors offer the most effective – in view of current conditions – strategy, founded on the implementation of the specific function of management – cost increase. This strategy of hotel business, aimed at cost increase, can be achieved by evaluation, monitoring, control, and management of determinants of cost which correspond to the main elements of the model of economic value added.

This model allows determining the directions for hotel business cost increase and allocating the main vector of development: increase of profitability of invested capital; expansion of business – increasing room supply, developing multi-brand business; combining ownership and management of a hotel; independent development of hotel business or joining a chain; optimization of the cost of invested capital.

Uncertainty of the current situation in the Russian Federation and in the world on the whole, caused by current economic conditions, raised the level of financial risks, and, as a result of sanctions against the Russian banks,

the costs for attracting sources of financing grew substantially. That's why the initial task is to optimize the cost and structure of invested capital.

For the purpose of formation of the structure of sources, the authors offer the well-balanced model of the financing sources structure. Implementation of the offered model allows:

- Identifying basic risks for activities which influence economic potential. The risks, related to investments into hotel business, are rather specific and not peculiar for investing into other real estate. The examples of basic risks for hotel sphere are the following: hotel rating, level of occupancy, reduction of average cost of accommodation, quality of service, level of management efficiency, etc.;
- Allocating reasons for emergence of basic risks and classifying them into controllable and uncontrollable;
- Setting interrelations between the reason for risk emergence – taking into account that the same basic reason can influence the change of various basic risks;
- Forming the model of “possibility for influencing the risk causes” and evaluating the quality of financing sources;
- Evaluating financial costs, related to financing the elimination of internal causes of risk. As to the causes which can be managed and controlled by enterprise, there are various variants of influence – so there may be developed alternative variants of measure, stipulating the reduction of their negative influence. For example, if the basic cause of risk is insufficient qualification level of production workers, the following measures are possible: increasing qualification of employees on the workplaces of organization, increasing qualification level through the system of retraining in the sphere, organizing visits to similar enterprises, etc. As a rule, implementation of such measures is connected to financial expenses required for their financing;
- Selecting the sources of financing of measures as to reduction of the level of risk spectrum of organization;
- Planning financial results for the following period, on the assumption of the strategic goal of functioning.

At that, it should be noted that all above mentioned advantages of the offered well-balanced model of financing sources structure could be realized only under the condition of effective system of corporate management.

#### 4. Conclusion

In view of the results of the conducted research, it is possible to conclude that the results of the research, given in the article, supplement the existing approaches to strategic management in the hotel business:

- Including procedures of financial substantiation of the strategy of development of hotel business which take into account the change of market cost;
- Possibility for managing the determinants of cost at various levels of management;
- Specification of the procedures of managing financial risks at the stage of hotel construction.

The offered model takes into account the most effective methodologies for creation of a complex system of risk management, which allows rational use of not only existing mechanisms of risk management but also of methods which are modified on their basis, in view of the specifics of activities of particular organization.

Implementing a well-balanced model of financing sources structure of hotel business enterprises allows allocating risks and their meaning at initial stages and developing measures for their minimization and liquidation. That's why the results of this research will be used by construction companies which are involved in construction of hotel objects and by managing companies and owners of hotel business, for increasing the efficiency of investment projects implementation.

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