THE IMPACT OF FOREIGN EXCHANGE VOLATILITY ON THE FINANCIAL PERFORMANCE OF HOTEL REAL ESTATE PRIVATE EQUITY INVESTMENTS IN SWITZERLAND

Doctoral Dissertation Submitted by

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Abstract

The shockwaves that hit financial markets amid the dawn of the global financial crisis in late 2007 did not only send several equity markets into free-fall, but simultaneously led to an increased level of volatility in global currency markets. One of the main drivers of this volatility is believed to have been the product of the so-called flight to safety, meaning that a large amount of capital was being shifted into safe haven currencies. Given that the Swiss Franc belongs to the very inner circle of these safe haven currencies, its value against several major international currencies strengthened considerably. In fact, currencies such as the British Pound and the Euro lost between 30-40% of their value against the Swiss Franc between 2007 and 2009. As a natural consequence, Switzerland – although stable as an economy in itself – was suddenly being exposed to severe economic pressures due to the mounting strength of its currency versus several other currencies.

Given the structure, seasonality and dynamics of Switzerland’s hotel industry, the risks of a strengthening currency and its potential negative implications for the national hotel industry were soon conceived as a latent threat to its wellbeing. In fact, it was not long until economic evidence came to suggest that a strong national currency would not only lead to a reduction in demand for discretionary spending among visiting guests, but naturally, also diminishing hotel revenue. Therefore, from a hotel investor’s point of view, it became obvious that extraordinary measures would be required in order to decrease, or at best, eliminate the vulnerability of hotel investment(s) to negative economic exposure. Considering the vast heterogeneity of Switzerland’s hotel industry, this study has found particular interest in identifying whether the characteristics of an individual property or a set of properties reduce or offset exposure to movements in certain currencies. More specifically, the study focused on measuring to which extent Hotel Real Estate Private Equity (HREPE) investors are able to reduce risk to Foreign Exchange (FX) exposure while at the same time enhancing the Financial Performance (FP) of their investments.

The analysis and discussion that has taken place in this study has been subject to an examination of financial and operational data from 76 resort properties located in 5 major tourism regions. Due to certain limitations with regards to data availability, solely the performance of 3 and 4 star properties has been taken into consideration. The timeframe in which the study takes place has been specified to be between 2007-2011 and the currency samples have been selected based on national tourism demand: US Dollar, British Pound, Chinese Yuan, Russian Ruble, Indian Rupee, Japanese Yen, Euro. Overall, one of the main aims of the study has been to measure the relationship and impact movements in each of the above currencies have had on the Financial Performance of the selected sample of properties between 2007-2011. It has done so by applying a quantitative research approach.

The data analysis that took place throughout the study has brought forward conclusive information regarding the Foreign Exchange exposure particular properties are subject to. It has been found that the level of Foreign Exchange exposure is dependent on property category, geographic location as well as the operational and financial structure of each property. The output of the study provides reason to assume that the exposure to risk prone currency volatility can be reduced or
even offset once active Financial Performance Management tools as well as Yield and Revenue Management (YRM) systems have been put in place. It has also been found that the exposure to certain currencies may be reduced according to the supply structure of a property and the reduction in certain costs. Moreover, the study suggests that Hotel Real Estate Private Equity investors have the ability to reduce Foreign Exchange exposure by allocating their capital into distinct individual properties or a portfolio of properties. Additionally, the study suggests that investors have the ability to hedge their currency exposure and at the same time profit from the upside potential a particular currency or set of currencies have to offer.

Succinctly, this study has been developed to provide insight into the existing dynamics between currency exposure and the profitability of hotel investments. It shall hence serve as a guide that allows investment professionals and academics alike to gain deeper insight into the field of hotel investing. Furthermore, the study has been designed to highlight the potential that lays within Hotel Real Estate Private Equity investing in Switzerland and in which way currency risks may be reduced while increasing the overall performance of a single property or portfolio investment. Furthermore, the aim of the study has been to provide the basis for future research within the field to take place. It may not be seen as a final and definite product, but rather as a foundation on which future research may be built upon. Last but not least, this study shall verify the potential that the Swiss hotel sector holds for new and innovative financing methods and that its characteristics provide highly advantageous currency hedging strategies for national as well as international investors.
Certification of Dissertation

I declare that the work presented in the thesis is, to the best of my knowledge and belief, original and my own work, except as acknowledged in the text, and that the material has not been submitted, either in whole or in part, for a degree at this or any other University.

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Signature of Casper Studer
………………………………
Date

ENDORSEMENT

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Signature of Dr. Peter Phillips
………………………………
Date

………………………………
Signature of Dr. Max Gsell
………………………………
Date
Dedication

I dedicate this work to my close circle of family members, especially to my parents, Barbara and Andrew.

“Never give up on a dream just because of the time it will take to accomplish it. The time will pass anyway.”

_Earl Nightingale_
Acknowledgements

I would like to take this opportunity to express my infinite gratitude to my principal supervisor, Dr. Peter Phillips, University of Southern Queensland, Australia, for providing me with the best imaginable support, motivation and advice one could wish for throughout the entire journey of this research project.

Special thanks also to my academic associate supervisors Dr. Taiji Watanabe, University of Southern Queensland, and Dr. Max Gsell, for sharing their valuable insight, experience and wisdom.

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I am especially grateful to my parents, Andrew and Barbara, for their constant love and encouragement. Without them, this piece of work would have – by all means – never come to life.

Zürich, 10 September 2013  
Casper Studer
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<tbody>
<tr>
<td>ARDC</td>
<td>American Research and Development Corporation</td>
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<tr>
<td>BE</td>
<td>Canton Bern</td>
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<td>BFS</td>
<td>Swiss National Bureau of Statistics</td>
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<td>CAPR</td>
<td>Capitalisation Rate</td>
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<td>CHF</td>
<td>Swiss Franc</td>
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<td>CI</td>
<td>Confidence Interval</td>
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<td>CNY</td>
<td>Chinese Yuan</td>
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<td>COGS</td>
<td>Cost of Goods Sold</td>
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<td>DM</td>
<td>Deutsche Mark</td>
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<td>DO</td>
<td>Days Open</td>
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<td>Euro</td>
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<td>EVA</td>
<td>Economic Value Added</td>
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<td>Financial Performance Management</td>
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<td>FX</td>
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<td>GARCH</td>
<td>Generalized Autoregressive Conditional Heteroscedasticity</td>
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<td>GBP</td>
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<td>GDP</td>
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<td>GFC</td>
<td>Global Financial Crisis</td>
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<td>GOP</td>
<td>Gross Operating Profit</td>
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<td>Gross Operating Profit Per Available Room</td>
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<td>General Partner</td>
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<td>Gross Profit Margin</td>
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<td>INR</td>
<td>Indian Rupee</td>
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<td>IRR</td>
<td>Internal Rate of Return</td>
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<td>KAG</td>
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<td>LOP</td>
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<td>PMS</td>
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<td>REVPAC</td>
<td>Revenue Per Available Customer</td>
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<td>ROA</td>
<td>Return on Assets</td>
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<td>Return on Equity</td>
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<tr>
<th>Abbreviation</th>
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<tr>
<td>ROIC</td>
<td>Return on Invested Capital</td>
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<tr>
<td>RUB</td>
<td>Russian Ruble</td>
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<tr>
<td>SECO</td>
<td>State Secretariat of Economic Affairs</td>
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<tr>
<td>SD</td>
<td>Standard Deviation</td>
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<td>SER</td>
<td>Standard Error of Estimates</td>
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<tr>
<td>SGH</td>
<td>Swiss Society for Hotel Credit</td>
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<td>SHA</td>
<td>Swiss Hotel Association</td>
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<td>SNB</td>
<td>Swiss National Bank</td>
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<td>TI</td>
<td>Canton Ticino</td>
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<td>USD</td>
<td>US Dollar</td>
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<tr>
<td>VC</td>
<td>Venture Capital</td>
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<td>VIF</td>
<td>Variance Inflation Factor</td>
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<td>VS</td>
<td>Canton Wallis</td>
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<td>YRM</td>
<td>Yield and Revenue Management</td>
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<td>ZS</td>
<td>Central Switzerland</td>
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