# REvenue & cost (R&C) dRIVERS

**Company Selection: Marriott Inc. and Johnson & Johnson**

## Marriott inc.

Marriott’s position as a mature market leader in full-service hotels & resorts gives rise to the question as to what their expense structure looks like, how they have developed such a strong offering, and where the apparent affinity of its customers to the brand originates from. To delve deeper into this, it is vital to map out the R&C drivers that underpin the global pure-play company’s operations.

**Hybrid-Hospitality:**

To identify and analyse revenue drivers, we must first determine how Marriott’s service offering can be split into sales inputs. Fortunately, the “Revenue Recognition” (p.41/42) section of Marriot’s Annual Report (2022) provides an applicable breakdown of their income statement, with reference to their revenue generation structure, and the proportionate make-up of these underlying drivers to their total revenue. By analysing these components, we can compartmentalise the wider business model that Marriot opts to utilise to fuel its market strategy.

Rev. Split:

Cost Reimbursement Revenue= 73.90%

Franchise Fees= 12.01%

Base Management Fees= 5%

Owned, Leased and Other Revenue= 6.55%

Incentive Management Fees= 2.54%

According to Marriott (2022), the prominent driver comes in the form of cost reimbursements, which “primarily consist of payroll and related expenses”. Naturally, this cannot be wholly considered a revenue driver due to the large degree of symmetry on the cost side, but it delineates the benefits of partially operating under the franchise model. Through risk transfer and capitalizing on the strength of the Marriot brand, an extra layer of protection is applied to their growth strategy, which can also enable a degree of focus on their own managed portfolio. This leads well into their second largest revenue driver with a value of $2.505bn accumulated in franchise fees, collected due to the use of their intellectual property. They are opting to charge both via “initial application fees and ongoing royalty fees” to come to this figure. The remaining 15.55% fee composition consists of the remaining three categories often met through their “performance obligations” on managed hotels, and other smaller sources such as fees related to design, termination, ancillary services etc.

Cost Split:

Reimbursed Expenses= 87.46%

Owned, Leased and Other-direct= 6.2%

General, Administrative, and Other= 5.15%

Depreciation, Amortisation and Other= 1.27%

Restructuring, Merger-Related Charges and other= 0.07%

As specified, the mirroring in cost-reimbursement revenue from the franchised hotels takes up the vast majority of the cost base. Excluding this fact, a primary cost driver is related to their managed properties, with owned, leased, and other costs taking up 6.2% compared to the generated proportionate revenue of 6.55% that it produces. This further contextualizes Marriot’s preference to principally operate through licensing and franchising, rather than stretching tight operational margins in a competitive hospitality industry. We can observe the outcomes of this growth strategy by the expansive coverage of different market segments, ranging from the bespoke experience offered by the Ritz-Carlton to the cost leadership strategy employed by TownePlace. Fixed costs arisen from the running of their centralised operations, in addition to accounting adjustments and organisational change costing are also applied (Marriott, 2022).

It is worth noting the premise of the franchise model is stimulated from the coveted Marriot brand itself, which have a myriad of underlying factors relating to its composition. A prominent contributor is their loyalty programme, Marriot Bonvoy, which adds an additional layer of value (e.g. room upgrades, lounge access and other amenities) to the consumer beyond the widespread elite service standards set by the conglomerate.

**Past, Present and Future:**

In order to encapsulate the relative performance of Marriott in light of the R&C drivers, it is vital to contextualise the data. The method of which will be a peer-benchmark and analysis included within the following. In the revitalizing year of 2022, Marriott managed to recover to an operating profit margin of 16.67%, and a net margin (after tax) of 11.35%. With direct comparison to another global incumbent in Hilton Worldwide Holdings Inc. (2022), margins were notably lower with Hilton boasting 23.87% and 14.31% respectively. A compelling case can be made for a degree of diseconomies of scale given the magnitude of Marriott’s operations. However, from an investor perspective, Forbes (2021) highlighted a valuable trend that continues as “Hilton’s consistently better profitability is rewarded by investors in the form of a higher valuation multiple (P/S)”. Therefore, further fundamental analysis beyond the income statement is required to assess whether investors are currently pricing in the outlook for both firms, with value judgements on strategic direction needed for more informed assertions. In regard to future prospects, Melius Research analysts state that “Marriott is clearly sending a message they want to play more of a role in the midscale market” (Yahoo! Finance, 2023). Time will tell if Marriott’s plot to extend their market coverage will lead to a sustainable competitive advantage in this dynamic sector.

## Johnson and johnson (J&J)

As a healthcare titan, J&J boast a multitude of products and solutions spanning across their “three business segments: Consumer Health, Pharmaceutical and MedTech”. Looming amongst the healthcare landscape is the question of how the major players will facilitate the transition into a post-pandemic world, and the impact on stability as they shift their focus from the urgent demand posed by COVID-19. Conducting an R&C analysis on J&J provides pertinent insights on the factors that could make or break this period for an influential organization within this space.

**Health is Wealth:**

In J&J’s annual report (2022) p.22-28, business segments are organised into tranches that exhibit the revenue drivers in a concise manner. On a global scale, J&J generated increased sales of “1.3% to $94.9 billion as compared to an increase of 13.6% in 2021”.

From the above graphic, we see the segment split in action, with minor year-on-year changes in each of the three revenue sources. Consumer Health, the smallest segment of the three, declined 0.55% from 2021 to 2022. Under the same period, the other revenue drivers in MedTech and Pharmaceutical grew by 1.36% and 1.71% respectively. It is clear that Pharmaceuticals have the largest influence on sales revenue, but to gain a detailed picture on underlying drivers, sub-categories have been established on p.25. Delving deeper in, Oncology and Immunology pose a degree of risk, given their proportionate value to the wider treatment pool. This exposes a sector-specific vulnerability, which relies on the efficiency of companies such as J&J managing the lifecycles of their most profitable treatments (e.g. Darzalex and Stelara), introducing new revenue-generating products before they become ‘generics’ in which the patent-end signifies a loss of viability. To retain their stature, R&D and proactive M&A activity are comparatively more important than in the majority of other industries.

Two compelling impacts to the cost drivers over 2021-22 are the increases in Cost of Goods Sold and other expenses, by $2.6bn cumulatively. J&J insinuate the rationale that these are not long-term cost base trends, with cost rises originating from “One-time COVID-19 vaccine manufacturing related exit costs”, “currency impacts”, “commodity inflation” and “write-down of certain investments in equity securities” amongst others (J&J Annual Report, 2022). It can be argued that these cost driver increases are largely cyclical or isolated, however these risks must be mitigated and could have potentially been counter-acted more effectively with appropriate hedges and risk management protocols in place. Excluding COGS, R&D and Selling, Marketing and Administrative cost drivers make-up the most significant portion of J&J’s cost base.

Pfizer provide an applicable competitive benchmark for J&J, especially when evaluating the impact a pandemic-transition can have, given they are the sales leader when it comes to provision of the COVID-19 vaccination. In 2022, J&J superseded Pfizer’s gross margin to a minor extent, with the former coming in at 67.26% compared to 65.77% (Pfizer Annual Report, 2022). However, net margins tell a different story, with J&J succumbing to a figure of 18.9% to 31.27% in Pfizer’s case. Outperformance over this year can be attributed largely to the focused market leadership in delivering the COVID vaccine, but this may play into J&J’s hands in the near future. With a broader diversification across segments, J&J may benefit from less reliance on individual revenue drivers, with the future dependent on the success in capitalizing on the pockets of the market they operate in, and how they expand further.

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