Chapter 1

Patel Motel Dhandho

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Asian Indians make up about 1 percent of the population of the United States—about three million people. Of these three million, a relatively small subsection is from the Indian state of Gujarat—the birthplace of Mahatma Gandhi. And a very small subsection of Gujaratis, the Patels, are from a tiny area in Southern Gujarat. Less than one in five hundred Americans is a Patel. It is thus amazing that over half of all the motels in the *entire country* are owned and operated by Patels. What is even more stunning is that there were virtually no Patels in the United States just 35 years ago. They started arriving as refugees in the early 1970s without much in the way of education or capital. Their heavily accented, broken-English speaking skills didn't improve their prospects either. From that severely handicapped beginning, with all the odds stacked against them, the Patels triumphed. Patels, as a group, today own over $40 billion in motel assets in the United States, pay over $725 million a year in taxes, and employ nearly a million people. How did this small, impoverished ethnic group come out of nowhere and end up controlling such vast resources? There is a one word explanation: Dhandho.

Dhandho (pronounced dhun-doe) is a Gujarati word. *Dhan* comes from the Sanskrit root word *Dhana* meaning wealth. Dhan-*dho,* literally translated, means "endeavors that create wealth." The street translation of Dhandho is simply "business." What is business if not an endeavor to create wealth?

However, if we examine the *low-risk, high-return* approach to business taken by the Patels, Dhandho takes on a much narrower meaning. We have all been taught that earning high rates of return requires taking on greater risks. Dhandho flips this concept around. Dhandho is all about the minimization of risk while maximizing the reward. The stereotypical Patel naturally approaches all business endeavors with this deeply ingrained *riskless* Dhandho framework—for him it's like breathing. Dhandho is thus best described as endeavors that create wealth while taking virtually no risk.

Not only should every entrepreneur seek to learn from the Patel Dhandho framework, but also the primary audience for this tome—investors and allocators of capital. Dhandho is capital allocation at its very finest. If an investor can make virtually risk-free bets with outsized rewards, and keep making the bets over and over, the results are stunning. Dhandho is how the Patels have exponentially compounded their net worths over the past 30-odd years.

I'm getting ahead of myself. Sit back, relax, grab a cool one, and mellow out. You're about to begin a remarkable journey—one that I hope is as rewarding and profitable for you as it has been for me and generations of Patel businessmen.

Gujarat lies along the Arabian Sea with a large, desirable coastline and several natural harbors. The Tropic of Cancer cuts right through the state. Over the centuries, it has always been an ideal location for trade with neighboring Asian and African countries—it has served as a melting pot of many different cultures over its rich history. The Parsis,

fleeing religious persecution in Iran, landed in Gujarat as refugees in the twelfth century and were warmly received. Similarly, the Ismailis arrived in the first half of the nineteenth century from Iran. For several centuries, Gujaratis were very used to traveling to, and trading with, their Asian and African neighbors.

Patels originally were known as *patidars*—loosely translated as landlords. Most villages in Gujarat had a patidar appointed by the ruler who was responsible for collecting land taxes, providing security, and running a streamlined farming operation. In medieval times, these patidars were chosen on the basis of their savvy management and farming skills. Patels usually had large families, and as the land was subdivided into smaller and smaller fragments for each son, farming became a tough way to make a buck. In the late nineteenth and early twentieth centuries, Ismailis and Patels from Gujarat migrated in significant numbers to countries like Uganda in East Africa. They went as traders or as indentured laborers to help build the railroads.

The Patels and the Ismailis have been a very entrepreneurial community for centuries, and, over the ensuing decades (with their soon-to-be-revealed Dhandho techniques), they came to control a large proportion of the businesses in Uganda. General Idi Amin came to power in Uganda as a dictator in 1972. He declared that "Africa was for Africans" and that non-Africans had to leave. Amin wasn't a big fan of the Patels who controlled most of his economy. The fact that most of these "non-Africans" like the Patels and the Ismailis were born in Uganda, had been there for generations, had no other home, and had all their businesses and property in Uganda meant nothing to Amin. For him, it was simple: Africa was for Africans.

Amin revoked the residency permits of all Asians regardless of whether they had any natural homeland to return to. The Ugandan state seized all their businesses and

nationalized them—with no compensation to the owners. A total of 70,000 Gujaratis were thus stripped of virtually all their assets and thrown out of the country toward the end of 1972.

The world had several hot spots in 1972 and 1973 that had a significant impact on the future destiny of these orphaned Patels. With the recent formation of Bangladesh in 1971 and the war with Pakistan over its independence, India was already reeling from a very severe refugee crisis. Millions of impoverished Bangladeshi refugees had poured into India. As a result, the Indian government refused to recognize the Indian-origin population being expelled from Uganda as having any right to enter India.

Amin's Patel expulsion also coincided with the tail end of the Vietnam War and the United States was dealing with a large influx of Vietnamese refugees at the time. President Nixon and Secretary of State Kissinger were well briefed on the Ugandan situation and were sympathetic to the plight of the Patels, but were limited in the number of Indian-origin refugees they could accept. Being "members of the Commonwealth," the vast majority of the Patels and Ismailis were allowed to settle in England and Canada. A few thousand families were also accepted by the United States as refugees.

The first few Patels who arrived in the United States went into the motel business. The thousands that arrived later followed the lead of the pioneers and also became motel operators. Why motels? And why did virtually all of them go into the same industry?

If we examine the history of ethnic groups migrating to alien lands, we notice a pattern: In Chicago, many of the early Irish immigrants became police officers while most housemaids were Polish. In New York City, Koreans dominate the deli and grocery business, Chinese run many of the

city's laundries, and Sikhs and Pakistanis drive most of the cabs. It's a bizarre sight, but most of the rental car staff at California's San Jose International Airport consists of older Sikhs—turbans and all. There is a large population of Eastern European cab drivers in Vegas, and most of the prostitutes in Dubai are of Eastern European or Russian origin.

The reason we end up with concentrations of ethnic groups in certain professions is because role models play a huge role in how humans pick their vocations. If someone looks like me, has had a similar upbringing, belongs to the same religious order, has attended a similar school, and is making a good living, it naturally has a huge impact when I'm trying to decide my calling in life. Tall inner-city African-American kids routinely see tall African-American males playing for the NBA and leading very enviable lives. They are also aware that the childhood of these NBA stars, in many cases, is pretty similar to their own present circumstance. It serves as a huge motivator to sharpen their basketball playing skills.

That still begs the question: Why did the first wave of Patels who entered the United States go into the motel business? Why not delis, Laundromats, or drug stores? Why motels? And why not just find a job? Part of the answer lies in another demographic shift that was underway in the early 1970s in the United States. After World War II, there was a huge buildout of suburbia and the interstate highway system. The automobile had become a middle-class staple, and American family-owned motels popped up all along the newly built interstates. The 1973 Arab oil embargo and misguided American economic policies (price and wage controls) led to a deep recession across the country.

Motels are heavily dependent on discretionary spending. The recession, coupled with rationed and sky-high gas prices, led to huge drops in occupancy. Many small,

nondescript motels were foreclosed by banks or went on sale at distressed prices. At the same time, the kids of these old motel-owner families were coming of age and saw plenty of opportunity outside of the motel business and left in droves to seek their fortune elsewhere.

PAPA PATEL

It is 1973. Papa Patel has been kicked out of Kampala, Uganda, and has landed as a refugee in Anywheretown, USA, with his wife and three teenage kids. He has had about two months to plan his exit and has converted as much of his assets as he could into gold and other currencies and has smuggled it out of the country. It isn't much—a few thousand dollars. With a family to feed, he is quickly trying to become oriented to his alien surroundings. He figures out that the best he can do with his strange accent and broken-English speaking skills will be a job bagging groceries at minimum wage.

Papa Patel sees this small 20-room motel on sale at what appears to be a very cheap price and starts thinking. If he buys it, the motivated seller or a bank will likely finance 80 percent to 90 percent of the purchase price. His family can live there as well, and their rent will go to zero. His cash requirement to buy the place is a few thousand dollars. Between himself and his close relatives, he raises about $5,000 in cash and buys the motel. A neighborhood bank and the seller agree to carry notes with the collateral being a lien on the motel. As one of the first Patels in the United States, Dahyabhai Patel succinctly put it, "It required only a small investment and it solved my accommodation problem because [my family and] I could live and work there."[1]

Papa Patel figures the family can live in a couple of rooms, so they have no rent or mortgage to pay and minimal

need for a car. Even the smallest motel needs a 24-hour front desk and someone to clean the rooms and do the laundry—at least four people working eight hours each. Papa Patel lets all the hired help go. Mama and Papa Patel work long hours on the various motel chores, and the kids help out during the evenings, weekends, and holidays. Dahyabhai Patel, reflecting on the modus operandi during the early days, said, "I was my own front-desk clerk, my own carpenter, my own plumber, maid, electrician, washerman, and what not."[2] With no hired help and a very tight rein on expenses, Papa Patel's motel has the lowest operating cost of any motel in the vicinity. He can offer the lowest nightly rate and still maintain the same (or higher) profitability per room than his predecessor and competitors. As a result, he has higher occupancy and is making super-normal profits. His competitors start seeing occupancy drop off and experience severe pressure on rates. Their cost structures prohibit them from matching the rates offered by the Patel Motel—leading to a spiraling reduction in occupancy and profits.

The stereotypical Patel is a vegetarian and leads a very simple life. Most restaurants in the United States in the 1970s don't serve vegetarian meals, so eating at home is all the more attractive—and much cheaper for Patel families. They are busy with the motel day and night, so they have little time for recreational activities. As a result, the total living expenses for this family are abysmally low. With a single beater car, no home mortgage, rent, or utilities, and zero commute, eating out, or spending on vacations or entertainment of any type, Papa Patel's family lives quite comfortably on well under $5,000 per year.

Prices are far lower in the 1970s—the minimum wage is just $1.60. The best Papa and Mama Patel could hope for is total annual earnings of about $6,000 per year if they both take up jobs and work full-time. If they buy a 20-room motel

at a distressed price of $50,000 with about $5,000 in cash and the rest financed, even at rates of $12 to $13 per day and 50 percent to 60 percent average occupancy, the motel will generate about $50,000 in annual revenue.

In the early 1970s, with treasuries yielding about 5 percent, an owner or most banks will be delighted to finance the motel purchase at a 10 percent to 12 percent interest rate with a lien on the property. Mr. Patel has annual interest expenses of about $5,000, principal payments of $5,000, and another $5,000 to $10,000 in out-of-pocket expenses for motel supplies, maintenance, and utilities. Total expenses are thus under $20,000. Even if the family spends another $5,000 a year for living expenses (a grand sum in 1970), Papa Patel nets over $15,000 a year after all taxes and all living expenses. If he had borrowed the $5,000 from a fellow Patel, he has it fully repaid in four months. He could even elect to pay off the mortgage on the motel in just three years.

The annual return on that $5,000 of invested capital is a stunning 400 percent ($20,000 in annual returns from the investment—$15,000 in cash flow and $5,000 in principal repayment). If he borrows the $5,000 from a fellow Patel, the return on invested capital is infinite: zero dollars in and $20,000 a year out. That's all fine and dandy you might say, but what if the business does not work out? What if it fails?

For this first motel purchase, Papa Patel not only has to give a lien on the property, but most likely also a personal guarantee to the lender as well. However, Papa Patel has only $5,000 (or less) to his name, so the personal guarantee is meaningless. If he is unable to make the payments, the bank can take over the property, but he has virtually no assets outside of the motel. The bank has no interest in taking over the motel and running it—it has no such competency. It will be very hard for the bank to sell a money-losing motel and cover their note.

It is very simple: If a Patel cannot make the motel run profitably, no one can. The bank's best option is to work with Papa Patel to make the motel profitable, so the bank is likely to renegotiate terms and try to help Papa Patel get back on track. They might defer principal and interest payments for a few months until conditions improve. And they might raise the interest rate to offset the pain they are enduring. It is net, net: Papa Patel still runs the motel; the family still lives there; and he works as hard and as smart as he can to make it—he has no choice. It's make it work or go bust and homeless.

Remember, this is an existing business with a very stable business model and a long history of cash flow and profitability. It is not rocket science. It is a simple business where the low-cost provider has an unassailable competitive advantage, and no one can run it any cheaper than Papa Patel. The motel business ebbs and flows with the economy. Eventually, conditions are likely to become better, the bank is made current on payments, and everyone is happy—most of all Papa Patel.

Let's look at this investment as a bet. There are three possible outcomes.

First, the $5,000 investment yields an annualized rate of return of 400 percent. Let's assume this continues for just 10 years and the business is sold for the same price as it was bought ($50,000). This is like a bond that pays 300 percent interest a year with a final interest payment in year 10 of 900 percent. This equates to a *21 bagger*—an annualized return of well over 50 percent for 10 years. Assuming a 10 percent discount rate, the discounted cash flow (DCF) stream is shown in Table 1.1.

Second, the economy goes into a severe recession and business plummets for several years. The bank works with Mr. Patel and renegotiates loan terms as described earlier.

Table 1.1 Discounted Cash Flow (DCF) Analysis of the Best Case for Papa Patel

Year	Free Cash Flow ($)	Present Value ($) of Future Cash Flow
Excess cash		0
1	15,000	13,636
2	15,000	12,397
3	15,000	11,270
4	15,000	10,245
5	15,000	9,314
6	15,000	8,467
7	15,000	7,697
8	15,000	6,998
9	15,000	6,361
10	15,000	5,783
10	Sale price 50,000	19,277
Total		**111,445**

Mr. Patel has a zero return on his investment for five years and then starts making $10,000 a year in excess free cash flow when the economy recovers and booms (200 percent return every year after five years). The motel is sold in year 10 for the purchase price. Now we have a bond that pays zero interest for five years, then 200 percent for five years, and a final interest payment of 900 percent (see Table 1.2). This equates to a *seven bagger*—an annualized return of over 40 percent for 10 years.

Third, the economy goes into a severe recession and business plummets. Mr. Patel cannot make the payments and the bank forecloses and Mr. Patel loses his investment. The annualized return is –100 percent.

These three outcomes cover virtually the entire range of possibilities. Assume the likelihood of the first option is 80 percent, the second is 10 percent, and the third is 10 percent. These are very conservative probabilities as we are assum-

Table 1.2 Discounted Cash Flow (DCF) Analysis of the Below-Average Case for Papa Patel

Year	Free Cash Flow ($)	Present Value ($) of Future Cash Flow
Excess cash		0
1	0	0
2	0	0
3	0	0
4	0	0
5	0	0
6	10,000	5,645
7	10,000	5,131
8	10,000	4,665
9	10,000	4,240
10	10,000	3,854
10	Sale price 50,000	19,277
Total		**42,812**

ing a one in five chance of the motel performing far worse than projected—even though it was bought on the cheap at a distressed sale price and run by a best-of-breed, savvy, low-cost operator. We have unrealistically assumed there is no rise in the motel's value or in nightly rates over 10 years. Even then, the probability-weighted annualized return is still well over 40 percent. The expected present value of this investment is about $93,400 (0.8 × $111,445 + 0.1 × $42,812). From Papa Patel's perspective, there is a 10 percent chance of losing his $5,000 and a 90 percent chance of ending up with over $100,000 (with an 80 percent chance of ending up with $200,000 over 10 years). This sounds like a no-brainer bet to me.

If you went to a horse race track and you were offered 90 percent odds of a 20 times return and a 10 percent chance of losing your money, would you take that bet? Heck Yes! You'd make that bet all day long, and it would make sense to bet a

very large portion of your net worth with those spectacular odds. This is not a risk-free bet, but it is a very low-risk, high-return bet. Heads, I win; tails, I don't lose much!

The skeptic in you remains unconvinced that the risk here is low. You might say that there is still the very real possibility of going broke if you bet all you have (like Papa Patel has done).

Papa Patel does bet it all on one bet, but he has an ace in the hole. If the lender forecloses and he loses the motel, he and his wife can take up jobs bagging groceries, work 60 hours a week instead of 40, and maximize their savings. At the 1973 minimum wage of $1.60, they earn $9,600 a year. After taxes, they can easily sock away $2,000 to $4,000 a year. After two years, Papa Patel could step up to the plate and buy another motel and make another bet.

The odds of losing this bet twice in a row are 1 in 100. And the odds that it pays off at least once are roughly 99 percent. When it does pay off, it's over a 20-fold return. That's an ultra low-risk bet with ultra-high returns—one very much worth making: Heads, I win; tails, I don't lose much!

With such high cash flow coming in, Papa Patel is soon flush with cash. He still has a very modest lifestyle. His eldest son comes of age in a few years and he hands over the motel to him. The family buys a modest house and goes hunting for the next motel to buy.

This time, they buy a larger motel with 50 rooms. The family no longer lives at the motel, but still does most of the work with little in the way of hired help. The formula is simple: fixate on keeping costs as low as possible, charge lower rates than all competitors, drive up the occupancy, and maximize the free cash flow. Finally, keep handing over motels to up-and-coming Patel relatives to run while adding more and more properties.

There is a snowball effect here and, over time, we end up with these amazing statistics—half of all motels in the United States are under Patel ownership. Having fully cornered the motel market, the Patels have begun buying higher-end hotels and have delved into a number of businesses where they can apply their lowest-cost operator model for unassailable competitive advantage—gas stations, Dunkin' Donuts franchises, convenience stores (7-Elevens), and the like. Some have even branched out into developing high-end time-share condominiums. The snowball continues to roll down this very long hill—becoming bigger over time.