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An Examination of the Hotel Industry and Multi-Branded Franchisors

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Franchises dominate such industries as fast food, automobile, rental car, and cosmetics, but perhaps no business model is as dependent on franchising as the hotel industry. As a result, the hotel industry presents an interesting study on how multi-branded franchisors deal with unique issues affecting the relationships between the franchisor and its franchisee, suppliers and vendors, and the traveling public.

The Hotel Franchise Agreement

A company that wants to become a major player in the hotel industry will use franchising as a mechanism for growth because the capital investment costs are relatively reasonable, compared with developing or acquiring hotel properties on its own. In the context of such a relationship, the hotel chain allows the franchisee to use the hotel chain's name, services, trademarks, and reservation systems in exchange for a franchise fee. To assure its success as a franchisor, the chain will recommend procedures that must be implemented. Naturally, if the brand name, image, and winning concept are successful, then the hotel chain will succeed in franchising its concept and procedures to prospective franchisees.

Additionally, establishing a franchising company does not require the significant personnel needed by a hotel management company. Of course, this does not imply that costs for developing and maintaining a successful franchisor are insignificant.

In today's competitive hotel industry, franchisors are constantly improving their brand awareness and recognition. To be successful and attract franchisees, a franchisor must: provide instant name recognition so that hotel patrons will want to stay at the franchisor's branded hotel; develop a market segment for the franchisor's branded hotel, whether it be leisure, resort, convention and meeting, government, and/or commercial; develop state-of-the-art manuals, procedures, and training programs as internal guidelines for operation and product merchandising; and institute chain-wide standards to ensure uniform mode of operating and image.

Along with the infrastructure needed to establish, maintain, and grow the franchisor's brand, comes the potential for growing pains associated with being a franchisor — specifically, the difficulty of working with franchisees and management companies. In that regard, the objectives of a franchisee and its franchisor might not always be the same. Consequently, the franchise company may spend a great deal of time and money attending to the problems of its franchisees.

The Multi-Branded Franchisor

In the past 7 years, single-branded hotel companies have consolidated into major hotel companies to form mega-hotel companies such as Marriott, Hilton, Intercontinental Hotels Group, and Starwood Hotels & Resorts. Each of these hotel behemoths now simultaneously markets multiple branded properties.

The Marriott line of hotels, for example, now extends beyond its upscale flagship accommodations and convention centers to include Marriott Hotels & Resorts, JW Hotels & Resorts, Renaissance Hotels & Resorts, Courtyard, Residence Inn, Fairfield Inns, Ramada International Hotels & Resorts, and Ritz-Carlton, each catering to different segments of the corporate and recreational travel business.

With the consolidation of hotel brands into mega-hotel companies, concerns arise about numerous elements of the franchisor-franchisee relationship. These include impact/ encroachment, maintenance of brand standards, vendor/supplier relationships, cross-selling and marketing issues, and the use of customer information. The discussion below describes how to resolve each of these issues satisfactorily, to the benefit of both the franchisor and franchisee.

Impact and encroachment: In the wake of the consolidation wave, issues common to all franchise operations are projected in bright relief in the hotel industry. One of these issues is the impact of multi-branding. Impact, also called encroachment, exists when the owner of a franchise brand, for example Intercontinental, wants to add a Holiday Inn in the same geographical vicinity as an existing Holiday Inn property.

While expanding the brand ultimately benefits everyone, Intercontinental must be sensitive to its existing Holiday Inn fran-

chisee's concerns that an identical hotel or even a sister-branded property, such as a Holiday Inn Express, could undercut its financial performance. From the franchisor's perspective, the "value" of the brand is predicated on distribution. In other words, the more franchised hotels that exist, the more successful the brand will be. If the franchisor does not expand in a given market, the brand will most likely suffer, and ultimately so too will its franchisees. Furthermore, if the system does not expand and create new hotel rooms, then reduced marketing funds will be available to promote the brand and its franchisees. If the franchisor is precluded from expanding in a given market because of impact issues, then those hotel room nights will go to the competition.

Most franchise agreements properly reserve the right for franchisors to add hotels at any location. Notwithstanding, franchisors recognize the concerns over encroachment. To address these concerns, often franchisors give franchisees certain rights, such as an "area of protection" clause and/or a right to an impact study.

An area of protection is a territory around the hotel in which the franchisor agrees not to license new properties, typically guaranteed for a term of 2 to 5 years. The limitation on the term should allow the existing franchisee time to "ramp-up," meet its pro-forma, and stabilize its average daily rate, occupancy rate, and revenue per available room. Once the term on the area of protection expires, the franchisor would be able to franchise or build another branded hotel within that area.

Another way to alleviate the franchisee's concern is to allow an impact study in order to estimate the revenues the existing franchisee will lose if the additional hotel is licensed. Franchisors that have impact-study policies generally require a certain threshold be established in order to trigger the denial of the proposed franchise. For instance, the franchisor may require the franchisee's hotel to quantify it will lose 3% of occupancy or 5% of room sales.

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Brand standards: Successful franchisors share a common goal — to provide a consistent brand so the traveling guest will have an expectation that each and every branded hotel visited will be similar. In other words, the franchisor provides quality assurance as one of its services. But more importantly, quality assurance is critical to the guests who are loyal to the individual brand. The quality assurance programs are important to keeping the quality of the hotels in the system up to system standards. Both the franchisor and franchisee should agree that guest perception is critical to the success of the brand and franchise.

A franchisor, as opposed to an independent operator, will inspect and issue annual reports about how well each hotel in the system meets brand standards. It should be noted that in most instances, the inspection and annual reports are beneficial to both the franchisor and franchisee. However, as can be expected, the inspection and report process can test the franchisor-franchisee relationship. For instance, the hotel brand may change or upgrade its standards, resulting in increased unplanned expenditures to the franchisee (although in many instances, the requirement to upgrade occurs when the franchised hotel is not performing to pro-forma).

It is common for the franchisor and franchisee to be at odds about the timing of such upgrades to the branded hotel. Notwithstanding, in today's ultra-competitive hospitality environment the franchisor is entitled, if not mandated, to be successful for and on behalf of its ultimate customer, the franchisee, in requiring these upgrades. By doing so, the franchisor will keep the various brands competitive and provide more hotel guests for its franchised hotels.

Vendor/supplier relationships: Stronger vendor/supplier relationships with franchisors are a major attribute of the multi-branded approach. For example, Marriott may use just one supplier to provide products to all of its multiple hotel brands. If the supplier is able to enter into a volume contract to supply multiple brands, then the costs to the hotel franchisor and franchisee should be lower.

Many vendors will give the franchisor a "rebate" or "commission" in exchange for the expanded business. Sensitive to complaints of perceived self-dealing, franchisors now are disclosing these rebate relationships to their franchisees and, in some instances, are distributing the funds to the franchisee.

Cross-selling and marketing the brands: Cross-selling of their brands is an issue facing multi-brand franchisors in all industries. In the hotel industry, to cite an example, Hilton owns the brands Embassy Suites Hotels, Doubletree Hotels, Homewood Suites, Hilton Hotels, and Hampton Inn. As part of its marketing plan, Hilton cross-sells all of it brands to the traveling public on a national, regional, and local basis.

When the franchisor offers reward programs, the guest benefits from cross-selling. With Hilton's HHonors Points & Miles Program, guests earn points and mileage regardless of which Hilton-brand hotel they use. This helps increase the rate at which rewards are earned, and it also promotes brand loyalty, as a guest may make it a priority to stay at a Homewood Suites when traveling to a city without a Doubletree.

While this may be good for the traveling public, when several of those different brands are placed within the same geographical market, the local and/or regional marketing efforts by the franchisor should be structured to support all brands equally, whether those hotels are franchised or corporately owned. To avoid any potential discrimination among the various brands, franchisors have adopted protocols, or rules of engagement. The protocols guarantee that marketing and advertising funds would not be spent on corporate-owned properties or a single brand only, but instead, ensure such funds would be distributed to benefit all brands equally.

Customer information: As with other franchisors that market to various segments of a particular industry, hotel franchisors inevitably accumulate a great deal of customer information. The franchisor may feel enti-

tled to use that guest information to cross-sell in a local market in the belief that it will benefit the brand as a whole, and the local franchisee in particular, by capturing market share.

The franchisee, however, might be reluctant to share guest information. Like a trade secret, the franchisee would not want customer accounts it cultivated to be used to benefit someone else, even a sister property. Similar to cross-selling, protocols should be developed on the use and entitlement to guest information to avoid future conflicts.

CONCLUSION

Franchisors and franchisees will continue to joust over impact, brand standards, vendor/supplier relationships, cross-selling and marketing issues, and the sharing of customer information.

Vendor rebates are a continuing point of contention between franchisors and franchisees, and the development of mega-hotel franchisors will only exacerbate the potential problem. However, perhaps no issue is more contentious today than cross-selling. It is not uncommon for a mega-hotel company to have multiple brands in the same area; one may be corporate-owned, and two or more may be franchised hotels. Special care must be taken with the company's choices in the allocation of marketing funding or other support to these properties to avoid any claims of discrimination. Franchisors often have a difficult time defending their decisions in these instances, making it imperative their marketing choices are as balanced as possible.

Although tension will likely always exist between the franchisor and franchisee over all of these issues, the successful resolution will require each to recognize that in the end, both sides benefit when the brand is prosperous.

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