



The Hotel Business

Chapter 2

Franchising

- Franchising and management contracts are the two main driving forces in the development and operation of the hotel business



Holiday Inn[®]



Franchising

- Began in 1907 by The Ritz Carlton
- A concept that allows a company to use other peoples' money for growth rather than financing
- Franchising is used to rapidly expand businesses
- The franchisee is granted the rights to use trademarks, operating procedures, and other business procedures
- Fees for lodging are generally 3–4% of room revenue



THE RITZ-CARLTON

Franchising

- **Benefits to the franchisee:**

- Standard set of plans
- National advertising
- Centralized reservation system
- Participation in volume discounts
- Listing in franchisor's directory
- Lower fee percentage charged by credit card companies

- **Drawbacks to the franchisee:**

- High fees
- Central reservation system accounts for about 7–26% of reservations
- Conformity
- Must maintain standards



Franchising

- Pros and cons for franchise company/franchisor
 - **Pros:**
 - Increased market share and recognition
 - Up-front fees
 - **Cons:**
 - Careful in selection of franchisees
 - Difficulty maintaining standards and controls





Is There a Franchise in Your Future?

- How might franchising involve you? You may:
 - Work directly for a franchisor.
 - Work in a franchisor-owned unit.
 - Work for a franchisee.
 - Own a franchise yourself!



Is There a Franchise in Your Future?

- Many mistakes made by new entrepreneurs have already been overcome by the franchisor
- The Franchisor offers many support services often including cash flow, marketing and advertising, site selection, construction plans, and assistance with financing.
- This leads to a key reason to buying a franchise...reducing your risk of failure!

Referral Associations

- Similar benefits to properties as do franchises—albeit at a lower cost
- Shared centralized reservation system and a common image, logo, or advertising slogan
- May offer group buying discounts to members, as well as management training, and continuing education programs
- Each independent hotel refers guests to each of the other member hotels
 - Hotels and motels pay an initial fee to join a referral association



Management Contracts

- Responsible for the hotel industry's rapid boom since the 1970s
- Little or no up-front financing or equity involved
- Provides operational expertise, marketing, and sales clout, often in the form of a centralized reservation system (CRS)
- Allows the hotel company to manage the property for a period of 5, 10, or 20 years
- The company receives a management fee (a percent of gross and/or net operating profit—usually 2–4.5% of gross revenues)

Management Companies

- Interstate Hotels & Resorts
 - \$2.6B
 - 374 Properties
 - 70K Rooms
- White Lodging Services
 - \$905M
 - 160 Properties
 - 24K Rooms



Real Estate Investment Trusts

- Investors do not pay corporate income tax and instead are required to distribute at least 95% of net income to shareholders
- Traded as stocks; they are much easier to get into (or out of) than limited partnerships or the direct ownership of properties



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Hotel Development

- Built as a business venture by a developer and because the developer expects to make a reasonable return on this substantial investment
 - A feasibility study is done to assess the viability of the project
- Two views:
 - It is often difficult for a new property to make a profit for a few years because of the higher cost of construction and the need to become known and gain a good market share
 - On the other hand, a remodeled hotel has the cost of remodeling to pay for plus higher operating costs for energy and maintenance, so they tend to cancel each other out

Economic Impact of Hotels

- Hotels provide substantial direct and indirect economic impact to the communities in which they are located.
- The indirect impact comes from the ripple effect
 - this is where money is spent by the employees (wages and salaries) of the hotel in the community.
 - It is also money used by the hotel to purchase all the items to service the guests.
- Communities also benefit from the Transient Occupancy Tax (TOT), aka the bed tax.
- SF 2013:
 - \$6.6B in activity
 - \$300M in taxes
 - 24,000 jobs
- Airbnb
 - \$56M impact
 - \$12.7M Rent

Classification of Hotels

- U.S. lodging industry consists of 50,800 hotels and motels
- Hotels may be classified as to location, price, and type of services offered
- AAA Diamond Award:
 - Inspecting and rating the nation's hotels since 1977
 - Less than 2% are 5 Diamond
 - AAA uses descriptive criteria to evaluate the hotels that it rates annually in the United States, Canada, Mexico, and the Caribbean

Types and Locations of Hotels

- **City center:** Meets the needs of the traveling public for business or leisure reasons
- **Resort:** Inclusive and diversified in accommodations
- **Airport:** Guest mix consists of business, group, and leisure travelers; generally in the 200- to 600-room size and are full-service
- **Freeway hotel and motel:** A convenient place to stay, reasonably priced, and with few frills
- **Casino:** Coming into the financial mainstream; casinos make more money from the gaming than from the rooms
- **Convention:** Provides facilities and meets the needs of groups attending and holding conventions

Types and Locations of Hotels

- **Full-Service:** Offers a wide range of facilities, services, and amenities
- **Economy/Budget:** Reasonably sized and furnished rooms without the frills
- **Boutique:** Unique architecture, style, decor, and smaller in size
- **Extended-Stay Hotels and All-Suites Extended Stay Hotels:** Majority of guests are long term. Additional space in the form of a lounge and possibly kitchenette
- **Condotels and Mixed-Use Hotels:** Combination of hotel and condominium. Hotel that may also have residences
- **Bed & Breakfast Inns:** Accommodations with the owner, who lives on the premises or nearby, providing a clean, attractive accommodation and breakfast

Best, Biggest, and Most Unusual Hotels and Chains

- The Oriental Hotel in Bangkok, Thailand has been rated #1 in the world; so, too, has the Regent of Hong Kong, the Mandarin Oriental of Hong Kong, and the Connaught of London
- The Ritz-Carlton and the Four Seasons are generally rated the highest quality chain hotels



Best, Biggest, and Most Unusual Hotels and Chains

- The Treetops Hotel in one of Kenya's wild animal parks—literally in the treetops
- The Ice Hotel—built from scratch on an annual basis with a completely new design, new suites, and new departments
- The Underwater Hotel at the Great Barrier Reef



Vacation Ownership

- Began in the French Alps during the late 1960s
- Fastest growing segment of U.S. travel and tourism industry
- For a one-time purchase price and payment of a yearly maintenance fee, purchasers own their vacation either in perpetuity (forever) or for a predetermined number of years
- Average cost to consumer between \$14,800 and \$18,500





Vacation Ownership

- Vacation clubs, or point-based programs, provide the flexible use of accommodations in multiple resort locations
- Members purchase points that represent either a travel-and-use membership or a deed real estate product
- Points are then used like money to purchase accommodations



International Perspective

- We are all part of a huge global economy that is splintered into trading blocks (i.e., the European Union and the North American Free Trade Agreement)
 - This comprises a total population of 441 million consumers
- In developing countries, once political stability has been sustained, hotel development quickly follows as part of an overall economic and social progression

International Perspective

- In Asia, Hong Kong's growth has been encouraged by booming economies and the kind of tax system for which supply-siders hunger. The Hong Kong government levies a flat 16.5% corporate tax, a 15% individual income tax, and no tax on capital gains or dividends.
- Several hotel chains have their headquarters in Hong Kong

Sustainable or Green Lodging

- By using local materials, a new hotel or resort can save money on the cost of materials plus the cost of transporting them
- The cost of energy has increased so much that lodging construction now incorporates ways of using natural lighting and building energy-efficient buildings
- Energy-efficient buildings require far less air conditioning because they use materials such as darkened glass and lower-wattage lighting that produces lower temperatures



Trends

- Capacity control
- Safety and security
- Assets and capital
- Technology
- New management
- Globalization
- Consolidation
- Diversification within segments
- Rapid growth in vacation ownership
- Increased number of spas and treatments
- Gaming
- Mixed-use properties
- Sustainable lodging development

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