Franchising and 15 reasons supporting brand affiliation

Christian Walter, Managing Director, PKF hotelexperts Vienna

In recent years, the topic of franchising in the hotel industry in Germany and in Europe as a whole, has clearly gained more importance and relevance. Various trends have helped to support this development. On the one hand, the expanding market dominance and influence of international hotel brands is forcing an increasing number of independent hoteliers to become part of a recognised hotel brand. Based on the sample collected by PKF hotelexperts within the German hotel market, approximately 79% of properties in Germany with at least 100 rooms can be considered branded (as of 2016) – the so-called brand penetration is relatively high. It can be assumed that the share of branded hotels in the overall market will continue to rise.

On the other hand, the large international hotel groups have for some time driven their growth via franchising – lease and management contracts directly concluded with these groups are now being pushed into the background. So-called white label operators are benefiting from this development and enjoying their heyday. While until recently there was only a handful of reputable market players in this field (who were also bankable and investor friendly), an increasing number of companies are striving to join this lucrative market. The business model can be easily explained: the project developers want a strong name for their hotel and an exit-viable lease. On the other hand, large international hotel groups want to secure projects but are not willing to offer a lease contract (quite often because it is considered too heavy for the balance sheet). The so-called *tripod model* offers a way out – the project is therefore based on three instead of two pillars: developer/investor, brand owner and (white label) operator. The developer/investor and the operator conclude a lease contract. In turn, the project developer is content because they are in a better position to attract the interest of a big institutional end investor. Finally, the white label operator generally has no problem signing a lease contract – as a rule, there usually remains an attractive sum left after the lease and franchise fees. Although these brand affiliation charges reflect an additional financial burden, many white label operators seem to be able to maintain a lean operational structure to absorb these added costs. The project then bears a strong brand name upon conclusion of a franchise agreement between brand owners (the franchisor, usually one of the large hotel groups) and operators (the franchisee).

Based on the sample of PKF hotelexperts, the German hotel contract landscape is as follows (source: PKF hotelexperts Contract Survey 2016): While approximately 44% of hotels (as viewed from the brand providers'/hotel groups' perspective) are operated under lease agreements and approximately 6% under management contracts, franchise contracts represent 21% – with the tendency of rising.

In this context, it is important to address the question of what advantages are created by brand affiliation. Before trying to answer this from an industry expert's point of view, it may be noted that the author is frequently confronted by his clients (mostly project developers and investors) in his daily consulting work, with the thesis that a brand may not be necessary at all and that the successful positioning of the hotel in a largely saturated market may even oppose it. One should always be open to such discussions and certainly not all hotels, especially individual concepts, need to be branded to be successful. Also as an outcome of such discourse, here are 15 reasons that speak for brand affiliation:

1) Marketing

One of the main reasons for selecting brand affiliation lies in the possibility to benefit from the existing marketing infrastructure of a large hotel group. While the development of a single brand is usually very time-consuming and requires significant initial investment with a flow of ongoing expenses, the franchisee can benefit instantaneously and without large initial costs from national and global marketing activities. This includes the brand's website, brand books, merchandise items and participation in relevant tourism fairs. Many of these activities could not be financed by a single hotel property. Naturally, marketing measures of large hotel groups (which are covered by marketing fees paid by the franchisee to the franchisor) don't always benefit individual hotels but are more focused on the brand as a whole. In this context, it should be noted that the franchisor's marketing infrastructure does not replace the need for the franchisee to have its own property-specific marketing activities and respective budget in place. Below the line, the marketing expenses may not be lower but the overall reach should be greater.

2) Distribution channels

Distribution remains a key component and advantage of a franchise system and associated branding. At the heart of the distribution structure of the franchisor is usually the central reservation system (CRS). Through this system, the single hotel participates in the distribution force of the hotel group. However, the significance of the reservation system (beyond the possibility of the technical handling of a reservation) has decreased considerably in recent years due to the emergence of online line travel agents (OTAs). Nowadays the notorious OTAs are also offering unbranded individual hotels (expensive but effective) access to worldwide functioning distribution channels. Nonetheless, the CRS still plays a significant role in the sales mix. Especially in markets where brand penetration of the franchisor is low, the CRS is likely to generate significant demand.

In this regard, when assessing whether to brand your property, you should be aware how many properties the franchisor has in the market. The higher the number of commonly branded properties, the greater is the possibility that this could lead to cannibalism. Within this context, it is important to make sure that an area of protection or competition clause is anchored in the franchise contract. This stipulates that the franchisor is not allowed to open a hotel under the same brand for a certain period and within a defined area i.e. radius to the franchisee's property.

3) Customer Loyalty Programme

The franchisor's loyalty programme is a further argument for a brand. The customer loyalty programme is a powerful marketing tool, particularly in the guest segment of international travellers. For example, who has caught themselves booking a more expensive Star Alliance flight, even though a similar ticket would have been cheaper on the so-called low-cost airline? Customer loyalty programmes usually result in amenities and status-related privileges which one is reluctant to do without. A Los Angeles business traveller who is a member of a hotel customer loyalty programme is most likely to consider a hotel in which they can benefit from these privileges when they travel to Berlin and thereby maintain or expand their status.

An individual hotel, which does not belong to a brand or other marketing consortium, can only rely on its own property, rather than on a global network, to retain its customers. In addition to the advantages resulting from a customer loyalty programme, the associated costs must also be considered. As a rule, a one-time programme fee needs to be paid to participate.

The hotel also pays for the points which loyalty members collect during their stay at the respective property. The hotel does get reimbursed for guests who redeem their points at this property (which can also be considered as an added source of demand and revenue). The amount the hotel receives per room night is generally a set amount pre-determined on an annual basis by the hotel group. In some cases, the daily published room rate is paid during peak demand periods i.e. when the hotel exceeds a certain level of occupancy (e.g. 95%).

In this context, however, one must ask the question again: What costs would be associated with a customer loyalty program fitting to one's own brand?

4) Product brand standards

The main idea behind franchising continues to be standardisation. In the age of individualisation and non-conformism, the hedonist may no longer need a tired smile for this concept. The value of standardisation, however, is not to be underestimated. Franchise hotels also have a high degree of standardisation. Just as you might have asked yourself in which city you are in when you are sipping a café latte at any Starbucks, the room products of so-called hard franchisor brands are extremely uniform. Advantages and disadvantages can also be compared here. The fact is that there is a recognition effect which is a value for many travellers: one knows what to expect – unpleasant surprises are generally avoided. In general, this also applies to the brand promise: no matter where in the world one books a hotel of the brand X, one can assume that certain brand standards are respected regarding the product. For example: each room has a safe, an electric kettle and a hair dryer. These standards may lose their importance in our geographic region, but there are still numerous destinations where these features of differentiation can be used in a positive sense. The standardisation is not only helpful for guests, but also from the viewpoint of the project developer, operator and investor. Standardised hotel products usually have a detailed description of the building and equipment requirements which leave out room for doubt. This offers the project developer and investor a high degree of planning security. Additionally, the operator does not need to reinvent the wheel – while for an individual concept, all equipment features must first be defined, with franchising one can take advantage of an existing concept. This machinery can also be the driving force behind rapid expansion: a developer who has learned the standards can perhaps open two or three properties of the same brand in Berlin or ten or twenty properties in Germany.

5) Operating Brand standards

Standardisation not only applies to the construction and equipment of the hotel but also to the operation of the property. The brand standards generally refer to the tangible elements of a hotel building as well as the operational procedures which are documented in the so-called standard operating procedures (SOPs). Without a brand affiliation, these standards would first have to be elaborately defined and documented. Whereas with franchising this is part of the standardised system.

There is also no need to worry about the ongoing development of these standards, as these are usually updated at regular intervals by the franchisor, with the improvement measures being provided based on experience gained from, amongst others, all the properties in the brand network. As it often happens, this can be a blessing or a curse – adapting to new or revised standards can also result in additional costs.

6) Support for operational optimisation

Providing the standards for unified work processes is one thing. Successfully implementing these and, if necessary, constantly improving them is the other. A franchising system generally provides support here as well. Whether compulsory or on an optional basis, franchisors usually offer operational optimisation measures and develop additional tools to improve operational processes and to achieve higher customer satisfaction, revenue and profit. One example of this could be a revenue management software developed specifically for the franchising system, which is only made available to franchisees. Additionally, concrete training measures are offered to introduce and to help successfully make use of these tools and to improve employee qualifications.

For example: How can the time required to clean a room be reduced? How can the menu look more attractive in the restaurant and thus be used to increase sales? Ultimately, the franchisors offer their franchisees consulting services that would otherwise have to be bought from third parties. The advantage of this option lies, in the ideal case, in the fact that the franchisors know their own products best and learn appropriate lessons from mistakes that have occurred elsewhere in the franchise system. It should be noted that these franchisor services are often in addition to the regular franchise fees; often additional fees need to be paid.

7) Technical Services

Already during the planning and construction phase, the franchisor is available to the owner and the operator in the framework of a so-called Technical Services Agreement (TSA). In the ideal case, the previously mentioned building and equipment requirements are not the only guidance provided. The franchisor accompanies the project development in an advisory capacity and supervises the proper implementation of the brand standards. This, of course, is not entirely unselfish. It is in the interest of the franchisor that a hotel is handed over to the operator which meets the brand standard requirements and can be integrated smoothly into the global franchise system. However, the franchisor's support should not end here. A TSA should also cover those areas that are not subject to brand standards but require relevant expertise, founded on extensive experience gained from similar projects. The less experienced the owner and/or operator are in the hotel project development process, the more important is the professional support by the franchisor in this area. This additional service costs extra (and is generally mandatory) – usually the franchisee must pay a so-called Technical Services Fee to the franchisor which is calculated per guest room.

8) Growth opportunities within the network

A reason for franchising, which is not to be underestimated by a hotel operator interested in expanding their hotel portfolio, is the growth opportunities which can arise from the franchise network itself. Once you are a franchisee of a brand, it may arise that the franchisor approaches the operator with additional projects and opportunities to work together. It is not just operators that approach franchisors. The large hotel groups also proactively rely on their proven franchisees. This is the ideal scenario to develop strategic partnerships where the franchisee enjoys a special status, which may also be associated with better franchise conditions.

9) Quality control and assurance

As a member of a hotel franchise network, one is subject to reoccurring quality control and assurance measures. Partially these are internal measures, which are defined by the brand standards of the franchisor. The actual control process is undertaken by the franchisor themselves or by a qualified third party. The quality controls can be mandatory and are anchored in the franchise agreement. Others are optional, which means that the franchisee can freely decide whether to carry out such inspections e.g. with the aim of increasing quality standards, etc. The entire quality assurance system of a franchise network can be viewed as another reason for branding. Building one's own quality assurance system (and consistently overseeing its implementation) can be time-consuming and costly. The introduction of an already existing system can be achieved in a cost-efficient manner. In addition, the external controls (e.g. mystery visits and shop calls) create a certain pressure or expectation that calls for self-discipline. External pressure is always a good medicine for helping to make sure that things get done.

10) Benchmarking

A fundamental advantage of brand association and franchising is the possibility to compare the performance of one's own company with other members of the network. One can speak of group-internal benchmarking or even of peer reviews. Usually, the franchisor offers appropriate forums and conferences upon which an exchange can take place between the various franchisees. You can compare your own performance with colleagues from the same city or similar destinations. It is also possible to help find best practice examples; how has another franchisee solved a particular problem or successfully implemented certain ideas and measures? Of course, this can also be done to some degree between non-branded properties. However, within a franchise network it is clear who the colleagues are and where to find them. In addition, one has a commonality – the brand – and thus also a comparable framework.

11) Lower market barriers to entry

Brand affiliation can also create lower barriers to entry. This can already be evidenced in the early project development phase. When initially seeking to find an operator for a new hotel project, the large hotel groups are contacted to elicit their interest in the project. It is not uncommon that the hotel groups respond favourably to a project in tandem with a preferred franchisee. This results in the franchisee being introduced to a project which very possibly would not have been offered to them otherwise.

Furthermore, brand affiliation can have a positive influence on the approval process for a new project. Especially the local political bodies tend to view a hotel project with a known brand more positively. Their expectations can be that a brand will raise special awareness, receive a positive image transfer, create brand-induced additional demand and possibly to adorn themselves in a positive light. Above that, the hotel can enter the market with a certain tailwind. A strong central reservation system of a renowned brand can, in a comparably brief period, create a base of demand for which an independent hotel may very well need to work harder to achieve.

12) The *tried and tested*-argument

An obvious benefit of a franchise system is that all products and concepts are tried and tested. One does not engage in an experiment but rather chooses something which has (hopefully) been tested and has succeeded over time. It might sound boring and not be so adventurous, but probably the security is the most decisive factor for the owner and operator. For a potential franchisee, there lies ample opportunity to closely investigate the franchisor during the selection process – this does not exclude talking with other franchisees who operate their hotel under the respective brand. As previously discussed, this security is equally important to the owner i.e. project developer or investor. It cannot be empirically proved that brand affiliation leads to a higher level of success, but banks and institutional investors often see branding as being synonymous with security and therefore as less risky than unbranded properties.

13) Economies of scale

Economies of scale are especially predominant in the area of purchasing. Many franchisors offer a type of buying syndicate in which they can negotiate lower prices based on the quantity of hotels in the purchasing network. This plays a role not only for operating supplies but also in the procurement of equipment during the development phase (for example for television units, mattresses, sinks, room furnishings, etc). Another benefit of this is that the offered products also conform to the brand standards. Although it is an open secret that groups may receive incentives from the listed suppliers, the economies of scale generally result in lower prices to the franchisee.

14) Innovation

Another argument supporting brand affiliation is the innovative capacity which a brand should possess. This does not mean that the large hotel groups and brands lie at the forefront of innovation. On the contrary, some of the best recent innovations in the hotel industry (certainly in Europe) originate from small regional market players (this is one of the reasons why some of the bigger hotel groups have taken a financial stake in companies which created a niche product e.g. *AccorHotels* partnering with *25hours Hotels*). However, monitored over a longer period, a high probability exists that a global brand, supported by its financial resources, has the necessary means to be innovative.

15) Franchisor's support

Due to the growing competition in the franchise landscape and the fact that franchisees are often seen as strategic partners to expand the hotel groups' presence in the market, some franchisors have realised that it is not sufficient just to have a strong brand to offer but that in some cases franchisees also need financial support to realise their projects. Some franchisors are willing to provide such support via key money.

This can for one be the final criteria which leads the franchisee to select the respective franchisor over other possible players in the market. Furthermore, the operator can use this key money to help finance the pre-opening budget or use the funds as a contribution to the FF&E. Of course, such financial support is generally only provided for projects which are of strategic importance to the franchisor and where it can be assured that this money would be amortised rather quickly via future franchise fees and charges. Another support for the franchisee can come in the form of providing a financial guarantee to the owner (for example for a lease contract). Such guarantees require a certain capital base and credit-worthiness which some franchisees i.e. white label operators don't always possess. In this case, it can be helpful to have a large international hotel group at your side.

Surely, there are many other reasons for choosing to brand a hotel. Possibly in another article a similar amount of points will be documented speaking against branding. There is no generic answer to the question "Brand – yes or no?". The author's aim is to show that there are many good reasons to choose brand affiliation. Each hotel project will have distinctive characteristics which will influence the decision and the pros and cons need to be analysed and weighed before deciding which option will work best. Some of the key influencing factors are the respective location and market dynamics in which the project is situated. A developer should also consider their exit strategy and how it will be impacted by the decision. Additionally, the topic of self-actualisation and strategic outlook may also need to be considered. Besides choosing brand affiliation or no brand, the option also exists to create one's own brand. Although this is not an easy path to take, if successful, one can create an additional value whereas with franchising one is contributing to enhancing a brand of a third party.