BRANDING IS KEY TO HOTEL GROWTH

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Brand names hang over the door of an increasingly significant proportion of UK hotels. Their number will grow.

In my 2011 report on UK hotel industry supply (using end-2010 data) I estimated that 39.7 per cent of UK hotels were part of corporate chains and a further 6.6 per cent were part of consortia. Taking the long-term view, by 2030 two-thirds of hotel rooms are likely to be branded as part of a corporate chain or consortia.

Despite this trend, we should not fear the total loss of the independent hotel. If 66 per cent of the 2030 UK hotel industry is branded, almost 300,000 hotel (and bed and breakfast) rooms will remain unbranded – probably smaller properties with entrepreneurial owners with the focus on quality, service and building a loyal clientele.

However, the opportunity for entrepreneurial spirit is not solely confined to the independent sector as the brands claim that they also provide an opportunity for it to thrive by providing the standards, systems and tools of the trade, as well as the customers through their reservations systems and loyalty schemes. At the same time, although the recent recession has shown that there can be pitfalls along the way, owners and franchisees provide financial capital alongside energy and endeavour.

Of course, franchising is not new to the UK hotel market though it has undergone recent rapid growth and its structure is changing. It wasn't that long ago that Whitbread held the master franchise for the Marriott brand in the UK, the Real Hotel Company (formerly Choice Hotels Europe) held the master franchise for Choice Hotels International's brands and Jarvis Hotels held the UK master franchise for the Ramada brand. Those days are gone and most of the major companies that are franchising their hotel brands in the UK are now doing so directly from the parent or through a UK subsidiary.

In global terms five of the top six of the world's largest hotel companies – InterContinental Hotels Group (IHG), Wyndham, Hilton Hotels, Accor and Choice Hotels International – are active in the UK market through franchising. The exception is Marriott International. Indeed, at present Wyndham and Choice are only active through franchising whereas the others are also active through other business models including management agreements, leases and (in limited cases) through development and ownership. Wyndham has stated that it will consider management agreements in the future but it seems this will be mainly for opportunities for the full service Wyndham Grand, such as the 154-room Wyndham Grand Chelsea Harbour which it already manages, rather than in mid-market and budget hotels.

The UK's two largest budget hotel chains, Premier Inn and Travelodge, have shied away from the franchising model despite having products which would apparently lend themselves to it. Travelodge has two properties in mainland UK that are operating under franchise, both being a legacy from previous ownership, and currently has 11 properties in Ireland, which it previously owned, under a master franchise. Premier Inn does not operate through franchising.

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The only company in the UK budget hotel market that started up as a pure franchising operation is easyhotel, now with 18 hotels, nine in the UK, eight in the rest of Europe and currently its only Middle East opening, in Dubai. In this case the company is leveraging the 'easy' brand rather than initially having the brand presence in the hotel sector.

The largest of the companies, IHG, franchises almost 3,900 of its hotels worldwide, manages 646 and owns just 10. A breakdown of its European portfolio is shown in the table below.

InterContinental franchises 94.2 per cent of its hotels in the Americas but around 85.5 per cent globally, including 83.6 per cent in the European region. The higher proportion in the Americas is due to the fact that the company started as an almost pure franchising company in the USA; international expansion has seen the need to incorporate different operating models.

Franchisor hotel companies and brands available for Franchise in the UK (2012)

	Full Service	Mid-market (standardised)	Mid-market (variable design)	Budget (standardised)	Budget (variable design)	Lifestyle
InterContinental Hotels	Crowne Plaza		Holiday Inn	Holiday Inn Express		Indigo
Wyndham Hotel Group			Ramada	Ramada Encore, Super 8	Days Inn	
Hilton Hotels & Resorts	Doubletree	Hilton Garden Inn		Hampton by Hilton		
Accor	MGallery	Novotel	Mercure	ibis, ibis Budget	ibis Styles	
Choice Hotels International			Clarion, Quality Inn		Comfort Inn	
easyhotel					easyhotel	

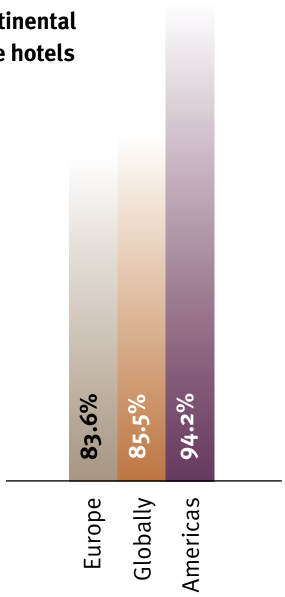
Source: InterContinental Hotels Group (as at 30 June 2012)

Summary of InterContinental Hotels' European portfolio by operating arrangements

	Owned & Leased		Managed		Franchised		Total	
	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms	Hotels	Rooms
InterContinental	2	917	19	6,299	8	1,912	29	9,128
Crowne Plaza	0	0	13	3,124	73	16,739	86	19,863
Holiday Inn	0	0	65	11,855	226	35,080	291	46,935
Holiday Inn Express	0	0	2	246	201	23,497	203	23,743
Staybridge Suites	0	0	1	128	3	477	4	605
Indigo	0	0	0	0	9	849	9	849
Total EMEA	**2**	**917**	**100**	**21,652**	**520**	**78,554**	**622**	**101,123**

Source: Melvin Gold Consulting research

InterContinental franchise hotels



Holiday Inn Express, the newest mass roll-out brand, was launched in Europe as almost entirely a franchise model. Although there were a few teething issues it did not take long for the brand to attract franchisee interest, especially in the UK, and even today 117 of the group's European portfolio of 203 properties are in the UK.

Indigo, IHG's new lifestyle brand, and Staybridge Suites, an extended stay brand, were launched almost exclusively as franchised properties although one of the Staybridge Suites properties is managed by IHG at present.

Currently Wyndham and Choice are only operating in the UK under franchise models. Wyndham has over 3,000 rooms under the Ramada brand (including Ramada Plaza), 4,500 Days Inn/Hotels branded rooms, and 2,277 Ramada Encore rooms. Choice's UK portfolio comprises 39 hotels (3,000 rooms), mainly under the Quality and Comfort brands.

Hilton UK portfolio predominantly consists of managed hotels but with an ever growing number of its estate operating under franchise agreements – now 22 out of a 109- strong portfolio, half of which is the full service DoubleTree by Hilton brand. This presents a strong opportunity for developers to pursue conversions of existing hotels, through both management and franchising agreements, whilst retaining a distinct sense of individuality for their property.

The more standardised brands, Hampton by Hilton and Hilton Garden Inn, are growing their presence in the UK as well as across Europe with many properties opening under franchise agreements. Both brands offer quality service to value-wise guests and have European pipelines of over 40 hotels each through a combination of management and franchising agreements.

Accor, Europe's largest hotel company and a franchisor of choice in France, has successfully deployed the franchise model in the UK in the last three years; the sector (together with managed hotels) now represents over 30 per cent of the company's UK portfolio which suggests that Accor, like many of the hotel brands and the consortia, has recognised that the future for UK hotels will be in branding.

In 2011, Accor signed franchise agreements with Focus Hotels (10 properties now operating under the Mercure brand) and Jupiter Hotels (26 Mercure properties, purchased by Patron Capital and West Register). The ambition is to grow the total portfolio to 300 hotels by the end of 2016, when around 60 per cent of the UK & Ireland portfolio will be operating under franchise and management contract structures. The flexible Mercure and ibis Styles brands are expected to be the driving force behind this growth.

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So why is franchising so important to brand holders when the business model offers them relatively little control of customer-facing activities – this, in an industry where customer-facing skills are so important? Careful vetting of franchisees and monitoring of their performance is therefore critical.

The big companies are attracted by the limited capital investment required, most having embraced the asset-light model. Reduced capital and the ability to work through a broad-based franchisee network enables more rapid network growth and better local knowledge (many franchisees are 'local' to a particular operating area).

Return on capital for the franchisor is typically strong, not least because capital expenditure is low, and a steady stream of fee income from an expanding network is an attractive proposition. This, however, depends on size and growth; for the franchisee, who now has a choice of brands to choose from, brand strength is key. The brand has to produce business. That depends on brand strength and marketing and a strong reservations system and online presence.

Major brands bring marketing muscle to hotel owners, including powerful global reservations systems, sales organisations, and customer databases. Often these are supported by loyalty schemes and consumer advertising. Normally these factors are on a scale that is simply beyond the reach of the independent hotelier.

One of the key factors in franchising is for the customer experience to be consistently achieved. A franchisee operating a poor standard franchise damages the whole brand. In the hotel world the model lends itself most easily to the mid- and budget markets. Not that the upper tier of the market lacks in delivery to the customer but it is more individualistic in style and that makes for a more difficult definition of standards and consistency of delivery.

However, franchising depends on the availability of finance and that has remained difficult to obtain in recent years. Higher equity requirements have further hampered progress. Most franchisees are small or medium sized companies and, given the economic environment, may have financial stress in their existing businesses and have difficulty in raising further capital from the banks. A number of franchise operators have fallen by the wayside this year.

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Franchising will no doubt continue its growth in the UK hotel industry

As a result, the claimed development pipelines of the big brands increasingly depend on the ability of third parties to be able to fund new development or to persuade independent properties to attach a brand to their premises. Even this requires capital – the properties have to be brought to compliance with brand standards.

As well as financing requirements, hotel owners and developers have to consider the cost of the fees payable to the franchisor and the cost of ensuring continued compliance with brand standards. For independent owners this is a huge issue because currently they are their own boss in this regard, able to control capital expenditure to their own timescale and pocket. That luxury departs with a franchise although undoubtedly compliance with brand standards will be better for customers in ensuring more consistent standards.

Fees are many and various and their quantum varies between the brands. There is normally an initial fee based on the number of bedrooms, a franchise fee based on a percentage of rooms revenue, system and reservation fees per reservation, and marketing fees. Normally there are no additional fees in respect of food and beverage and other revenue. For an existing property owner these costs have to be considered against the incremental revenue and profit that will be generated by a well known brand.

Franchising will no doubt continue its growth in the UK hotel industry in the years to come as the big companies seek to get bigger. Banks, already showing a preference for a brand name over the door rather than an independent operation, have gravitated even more towards this. With the influence of the internet and third party agents, hoteliers increasingly need to find a viable route to market through these important customer and revenue generating sources.

These factors combine to ensure that growth in the proportion of UK hotels that are branded or part of consortia will continue to grow in the coming years. Equally entrepreneurial spirit seems certain to ensure that franchising will become an increasingly prevalent business model in the UK hotel industry.

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