Hotel Investment Strategies

A Case For Being Independent

Most hotel owners and lenders believe a chain affiliation is an essential ingredient of a hotel's economic success. As with many things in life, decisions usually require tradeoffs, which sometimes lead to strategies that differ from the norm. This month I want to set forth the case of why a chain affiliation is not always the best decision, and every hotel owner should investigate the option of going independent.

A hotel obtains a chain affiliation in one of two ways: purchase a franchise that allows you to operate the hotel under a specific brand and participate in its reservation system, frequent traveler program and other marketing activities; or you can hire a branded hotel company to actually manage your hotel under a management contract and participate in its branding benefits. The main advantage of a pure franchise over a management contract is that you can operate the hotel and not relinquish management control. Examples of pure franchises are Holiday Inns, Days Inns and Comfort Inns. Branded management companies include Hyatt, Four Seasons and Hilton.

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The primary reason hotel owners opt for independence is the huge cost of affiliating with a major hotel company. According to HVS International's survey of franchise fees and other costs, approximately 8% to 11% of room's revenue ends up in the hands of the franchisor. This expense is equivalent to taking on a 25% partner. Successful independent hotel operators effectively use this money to promote and sell their own properties, which is often a good strategy for convention and extended-stay hotels that typically derive minimal benefit from a chain affiliation.

While a brand identification differentiates your property from other brands or independents, the recent rash of hotel chain consolidations has seriously reduced some of the benefits of affiliating. Twenty-five years ago when you obtained a Marriott franchise to brand your full-service hotel, you were probably the only Marriott branded hotel in the market. You effectively had exclusive use of Marriott's brand, reservation system and frequent traveler program for your local market. Today, you are probably competing with a host of Marriott products, including Courtyard, Fairfield Inn, Residence Inn and Ritz-Carlton to name a few. Hilton's mergers have created direct brand competition with Doubletree, Embassy Suites and now Hilton Garden Inn.

An independent hotel has none of these competitive conflicts of interest that can seriously erode profitability. Chains attempt to mitigate this potential by hiring outside consultants to measure the economic impact of allowing an additional hotel with the same or similar brand to enter the market. The process of quantifying economic impact is so subjective and fraught with bias, any hotel chain that relies on this approach in an attempt to appear fair and reasonable is shirking its responsibility to protect the interests of its existing owners. A much more equitable approach would be to negotiate a geographic area of exclusivity with the prospective franchisee that would require a chain's approval prior to granting a new franchise within the territory.

The last area of contention faced by many chain-affiliated owners is the regular change in brand standards, marketing direction and operating requirements. Franchisors seem to be regularly changing their logos, signs, reservation systems, technology requirements, marketing strategies and operating procedures. Each change typically requires a capital expenditure for the property, which comes out of the pocket of the owner. An independent hotel is free to spend money for projects it believes will offer the greatest economic benefit for the property.

While I am generally a believer that a chain affiliation is money well spent, don't over look the possibility of going independent.

For instance, if your hotel has one or more of the following characteristics, it might be a good candidate for independence:

- An extremely good location (Nob Hill, San Francisco)
- An architecturally significant building (Arizona Biltmore)
- A convention or extended-stay property
- A boutique hotel
- A prominent name (the Connaught in London)
- Exceptional management
- Unusual amenities (hot springs, views of the Grand Canyon)

Independence will save you money that can be put to good use based on your own discretion—not the franchisor's. All you need to be able to do is convince your other investor (your lender) that going it alone is a good decision. ◆

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