

EVALUATING THE TOTAL COST OF A HOTEL FRANCHISE

Every two years HVS evaluates the fees charged by hotel franchise companies in the U.S. The purpose of this analysis is to provide a comparative review of various hotel franchise brands based on the applicable franchise fees. The selection of an appropriate franchise affiliation affects a property's ability to compete in the local market, generate profits, achieve a certain image or market orientation and benefit from referral business. Because the success of a hotel is based primarily on the cash flows it generates, owners and lenders must weigh the benefits of a brand affiliation against the total cost of such a commitment.

When evaluating a potential hotel franchise, one of the important economic considerations is the structure and amount of the franchise fees. Second only to payroll, franchise fees represent one of the largest operating expenses for most hotels. Hotel franchise fees are compensation paid by the franchisee to the franchisor for the use of the brand's name, logo, goodwill, marketing and referral and reservation systems. Franchise fees normally include an initial fee with the franchise application, plus continuing fees paid periodically throughout the term of the agreement.

Payment of continuing franchise fees commences when the hotel assumes the franchise affiliation, and the fees are usually paid monthly over the term of the agreement. The following are some of the different types of continuing fees charged by franchisors:

Royalty Fee: Almost all franchisors collect a royalty fee, which represents compensation for the use of the brand's trade name, service marks and associated logos, goodwill and other franchise services. Royalty fees represent a major source of revenue for a franchisor.

Advertising or Marketing Contribution Fee: Brand-wide advertising and marketing consist of national or regional advertising in various types of media, the development and distribution of a brand directory, and marketing geared toward specific groups and segments. In many instances, the advertising or marketing contribution fee goes into a fund that's administered by the franchisor on behalf of all members of the brand.

Reservation Fee: If the franchise brand has a reservation system, the reservation fee supports the cost of operating the central office, telephones, computers and reservation personnel. The reservation fee contains all distribution-related fees, including fees payable to third parties, such as travel agents and distributors.

Frequent Traveler Program Fee: Some franchisors offer incentive programs that reward guests for frequent

stays; these programs are designed to encourage loyalty toward a brand. The cost of managing such programs is financed by frequent traveler assessments.

Other Miscellaneous Fees: This category includes fees payable to the franchisor or third-party supplier(s) for additional system and technical support. It also includes fees related to training programs and national and regional annual conferences. Sometimes franchisors offer additional services like consulting, purchasing assistance, computer equipment, equipment rental, on-site pre-opening assistance and marketing campaigns.

To provide a comparison of hotel franchise fees, HVS created three tables from information in the documents prepared by the respective franchisors. The tables divide the brands into three levels of quality: economy, mid-rate and first class.

The HVS franchise fee models (one for each class) assume a new hotel that opens and experiences a build-up of occupancy and room rate and operates under the franchise for 10 years. The various costs for the different services such as reservations, marketing, frequent traveler fees and miscellaneous fees are the estimated total cost for that 10-year period. The last column shows the total cost as a percentage of rooms revenue, which enables an easy comparison among the different brands.

Find the story and charts online at http://lhonline.com/development/franchising/rushmore_franchise_fees_0509/

In the economy class, the least expensive brand is Passport Inns, with its cost equaling 5.6% of rooms revenue, while the most expensive is Crossing Inns at 15.8%. In mid-rate, the least expensive is InnSuites Hotel Collection at 0.2% and the most expensive is Comfort Inns at 13.2%. In first class, the least expensive is Historic Inns of America at 0.6% and the most expensive is Westin Hotels at 17.2%.

Obviously the total cost of a franchise is only one factor that needs to be considered when selecting a brand affiliation. Numerous other components of the relationship such as the potential reservation output, competition from nearby hotels operating under the same affiliation, quality standard, termination provisions, impact procedures and more can make an inexpensive franchise undesirable or an expensive franchise highly desirable. Selecting the wrong franchise affiliation can be a very costly mistake, so when in doubt get professional help in making your decision.

To obtain a free copy (\$750 value) of the **HVS 2011 U.S. Hotel Franchise Fee Guide** send me an e-mail at srushmore@hvs.com.