Excellence in Hospitality Consulting
and Services Worldwide

Hidden Costs Of Franchise Agreements

Stephen Rushmore, MAI, CHA, CRE

HVS INTERNATIONAL
372 Willis Ave.
Mineola, NY 11501
516.248.8828 ph
516.742.3059 fax

October 2001

Hotel Investment Strategies

Hidden Costs Of Franchise Agreements

Many hotel owners do not read the fine print when they sign a franchise agreement and fail to completely understand their obligation to pay additional charges that sometimes exceed the basic royalty percentage. These hidden costs include items such as liquidated damage provisions, specialized technology, training and convention attendance. Let's look at some of these costs so you will be able to evaluate the total expense of operating under a specific hotel franchise.

Liquidated Damage Provision

Most franchises run for a 10- to 20-year term. If the franchisee wants to terminate the deal before the term expires, both parties have agreed through a liquidated damage provision exactly how the damage to the franchisor would be calculated. This saves needless litigation each time a hotel owner changes franchises before the term expires. The following examples show typical liquidation damage provisions:

Courtyard by Marriott: The sum of the average monthly contribution amount and royalty amount of 7.5% of gross rooms revenue over the preceding two years, times the lesser of 36 months or one-half the number of months that remain in the term of the agreement.

Crowne Plaza: A payment equal to a royalty of 5% of gross rooms revenue; a "service contribution;" a monthly technology fee; travel agent commissions; any additional royalties that may be charged on revenues from any activity if it was added at the hotel by mutual agreement; and any additional charges made for optional products or services during the preceding 36 calendar months.

Hawthorn Suites: A payment using a royalty fee equal to 5% of gross rooms revenue calculated for a specific number of months based on the average occupancy rate at the hotel for the 12 months preceding the termination as follows: If occupancy was below 50%, no liquidated damages; if occupancy was 50.0% to 59.9%, an amount equal to 12 months of royalty fee; if the occupancy rate was 60% to 69.9%, an amount equal to 24 months of a royalty; and if the occupancy rate was 70% or greater, an amount equal to 36 months of royalty fee.

Comfort Inns: Average monthly gross rooms revenue for the 12 months preceding termination, multiplied by the royalty fee payable in the remaining months, multiplied by the number of months until the next possible date on which the hotel could terminate without penalty, which are the 5th, 10th and 15th anniversaries of the opening date.

Key West Inns: Greater of US$11,000 or aggregate monthly royalties accrued over the 24 full calendar months immediately preceding the termination.

Courtyard wants a huge termination fee of 7.5% of gross rooms revenue. Crowne Plaza seems to cover almost every charge collected over the previous 36 months. Hawthorn reduces the damage calculation for poor occupancy performance. Comfort Inns allows owners to get out of their deal at three points in time without any damage payment. Key West Inns only charges for royalties over the past two years.

Hardware And Software

Many franchisors want to be connected to their franchisees and insist on specific computer hardware and property management systems (PMSs). These systems often require new hardware, expensive software, on-going maintenance and license costs. The following are examples of what it costs to comply with franchisor requirements.

Courtyard by Marriott: PMS, between US$49,000-US$52,000.

Doubletree: System 21 hardware, US$66,187 for a 300-room property; US$30,700 for implementation.

Summerfield Suites: PMS, US$16,000; PMS software support fee, US$100 per guest suite per year; and a software license fee, US$2,000.

Wyndham: PMS/telephone costs, US$1,500 per room; PMS support, US$28 per room per year; and US$2,100 per year for maintenance.

Baymont: ImagInn program, US$2,080 per year.

Microtel: Computer system, US$10,495; software maintenance, US$2,000 per year.

Hardware and software integration can be a very expensive cost for the new franchisee. If you are changing affiliations, it is unlikely your existing system will be totally compatible with the new one. You should definitely talk with a hotel technology specialist before signing a franchise agreement so you understand the various cost components.

Training, Meetings And Conventions

Some franchisors offer excellent training programs that show operators how to obtain the maximum benefit from their affiliation. In addition, franchisors want you to attend their regional and annual meetings. The following are typical costs for training and attendance at meetings.

Hilton: Director-of-sales orientation, US$750; front-office orientation, US$2,400; and Priority One guest relations training, US$550.

Sheraton: Property system training, US$3,500 per year.

Westin: Annual training, US$12,000; integrated property system annual training, US$3,500.

Howard Johnson: Orientation fee, US$595; owner orientation fee, US$295.

Sheraton: Global, national and regional meeting fees, US$2,000 per year.

Comfort Inns: Annual convention, US$550-$650; spring meeting, US$250-$350 per year.

Four Points by Sheraton: Company meetings, US$600-$800 per year.

AmeriHost Inns: Chain conference fee, US$400-$800 per person per year.

These are some of the hidden costs of operating under a hotel franchise agreement. You can find them outlined in the Uniform Franchise Offering Circular, which is a disclosure document issued by each franchisor. Other hidden costs you should look out for include: Global distribution fees, reservation expenses, Internet connections, accounting fees, maintenance and support, regional advertising, e-mail costs, satisfaction surveys, and travel agent costs. Hidden costs will add up, so be sure you understand what you are committing to before signing a franchise agreement. ◆

By Stephen Rushmore, *MAI, CHA, CRE, president and founder of HVS International, a global hotel consulting firm with offices in New York, Miami, Denver, San Francisco, Vancouver, Mexico City, London, New Delhi, Singapore, São Paulo and Toronto. Mr. Rushmore can be contacted at 1.516.248.8828 Ext. 204.*