Hotel Business Models

HOTEL COUNCIL AOTEAROA

Hotel Basics

Business Models

New Zealand hotels are owned and operated under different business models. The most common business models are (1) Independent/owner-operated; (2) Franchised; (3) Managed; (4) Leased; (5) Strata Title; and (6) Brand-owned.

No matter the business model in place, each hotel generally has its own separate legal entity – most often a limited liability company – through which the business *for the specific hotel at that location* is transacted. The relevant hotel-specific entity will typically enter into all contracts relating to day-to-day operations at that property, including employment contracts for front-line hotel employees.

Different business models have arisen in response to commercial decisions made by hotel investors and hotel management companies around the following issues:

- Who owns the hotel site and building?
- Is the hotel part of a larger chain of hotels operating under the same brand, or is it independently branded?
- Who sets and enforces brand standards?
- Who accepts the majority of the risk/reward from operating a hotel business at this location?
- Who makes day-to-day operating decisions at the hotel (including selecting and training employees)?

Business models of the largest hotel management companies

The world's largest hotel management companies include Marriott International Inc., Hilton Worldwide Holdings, Hyatt Hotel Corporation, Intercontinental Hotels Group and Accor SA. These global management companies all started out by being owner-operators. However, since hotel development is capital-intensive and requires destination-specific expertise and connections, it was quickly recognised that faster business growth could be achieved by splitting up *real estate ownership* on one hand, and *hotel operations* on the other.

To give a sense of this industry-typical split between real estate ownership and hotel operations, as at year-end 2020, Marriott International owned or leased just 66 hotels out of 7,642 hotels operating under its 30 brands worldwide. The largest hotel management company in New Zealand is Accor, which has 394 hotels under its brands in Australia, New Zealand and the Pacific Islands. Accor owns less than 1% of its global hotel portfolio.

The largest hotel management companies now achieve almost all of their incremental growth through this "asset-light" strategy, which avoids them making significant direct investment in hotel real estate. Instead, hotel management companies monetise their brands, scale economies, distribution channels, operating expertise and technology by entering into long-term agreements with third parties which own the physical real estate. Management agreements and franchise agreements are the two most common types of contract for this purpose.

Franchise and management agreements are also offered by small and mid-sized hotel management companies. A relatively new entrant into the hotel sector might look to offer third party franchise and/or management agreements on the back of only a few successful owner-operated properties. Such companies can in this way create strong local or regional brands, which are sometimes acquired by more established regional or global management companies.

Management agreements

Under a management agreement, the management company is appointed to direct and control the day-to-day operations of a hotel and to implement the relevant operational brand standards, subject to the owner having approval or consultation rights on certain matters (as set out in the management agreement). Management company is entitled to receive management fees, typically agreed percentages of revenue and profit. In effect, management company operates the hotel and owner supervises management company's performance.

In practice, management companies direct day-to-day decision-making by placing at the hotel an experienced general manager (GM) who is familiar with the relevant brand and "system". The GM has responsibility for building a team (if a new hotel) or managing the existing employees to maximise hotel performance while complying with brand standards. GMs are supported by "above-property" managers who provide additional assistance in certain business disciplines, such as HR, legal, sales & distribution or procurement.

Franchise agreements

Under a franchise agreement, the hotel owner pays a franchise fee (typically agreed percentages of rooms revenue and food & beverage revenue) to use the brand, IP, technology and operational brand standards at the hotel, subject to being contractually bound to conform with various "system-wide" brand standards (as set out in the franchise agreement). Owner still makes its own day-to-day decisions at the hotel. Under a franchise agreement, owner operates the hotel and management company supervises the owner's performance in its capacity as franchisor.

In practice, management companies tend to supervise franchise hotels through a combination of property audits, reviewing financial performance and providing access to above-property management support and resources on a "pay-for-use" basis.

Hotel franchise agreements should be distinguished from franchises offered in other sectors, such as food & beverage business franchises offered to "mum and dad" franchisees. Modern hotels are each large and complicated businesses in their own right. Management companies will typically only offer franchises to franchisees with a meaningful track record of successfully operating other hotels. Large hotels with 200+ guest rooms and multi-million dollar annual turnover might be operated under the franchise model. In practice, franchise agreements typically have *lower fees* than management agreements because hotel owners are consciously electing to retain greater control over the property's strategic decision-making and day-to-day operations. Hotel guests are unlikely to be able to differentiate between managed or franchised hotels.

Leased and strata title hotels

Leased hotels and strata title hotels are variations that can occur to either the management agreement or franchise agreement operating models. At leased hotels, the hotel business owner enters into a long-term lease for the physical real estate with a typically *passive* freehold owner, who has little or no say in the day-to-day operations of the hotel. With possession of the hotel real estate secured by way of a lease, the hotel business owner might operate the hotel business itself (either independently or under a franchise agreement). Alternatively, the hotel business owner might enter into a management agreement with a third party management company.

At strata title hotels, individual units/rooms in the hotel building are separately titled and the freehold is owned by individual investors. As with the leased hotel model, rooms are leased to the hotel business owner, which might then operate the hotel itself, enter into a franchise agreement or engage a management company to manage the hotel on its behalf.

Branding, business models and employment practices

Service consistency and quality is well understood to be a critical factor in the long-term success of any hotel. Labour is the largest operating cost at most hotels.

In response to an almost endless variety of guest preferences and needs, hotels offer varying levels of physical amenity and room size, and also different levels of service. These factors influence the average number of employees per guest room. At luxury hotels, it would not be unusual for the employment ratio to exceed 1:1 (one employee per guest room). At budget properties, the ratio could be much lower, 0.3:1 for example.

No matter the brand tier, one of the key reasons for entering into a franchise agreement or management agreement is to obtain access to the management company's employment-related systems and expertise. Since hotel employees are "guest-facing", management companies invest heavily in their employment-related systems in the hope that it improves employee performance and engagement, which in turn results in higher guest satisfaction and overall profitability.

Hotel owners enter into franchise and management agreements because doing so gives access to some or all of the following:

- A pool of experienced GMs and GM candidates who have past experience operating hotels of similar size and/or brand tier
- Employee recruitment advantages over independent hotels, such as brand-specific jobs portals, existing relationships with tertiary institutions, reputation as a good employer and the potential for employees to build a career internationally within the same hotel brand family
- Proprietary on-boarding and training programmes
- Attractive system-wide employee benefits, such as "employee rates" at other hotels operating under the management company's brands
- Expertise in relevant employee-related legal obligations and industry best practice
- Above-property HR and Legal support, as needed

Hotel management companies do not provide a centralised pool of labour – they are not contract labour providers of the type that exist in the construction sector. Under both the management agreement and franchise agreement business models, hotel employees will typically be employed by the hotel-specific entity. This hotel-specific entity is ultimately owned by the hotel business owner, not the management company. Management companies often manage and control many aspects of the employment relationship *on behalf of the hotel business owner/hotel-specific entity*, but typically they would not directly employ any on-the-ground hotel staff under their own corporate subsidiaries.

The largest global hotel management companies have had considerable success building a strong track record of employee satisfaction and the franchise and management agreement business models are well-understood and accepted globally. Examples of international recognition for employment practices at major hotel management companies include awards won by Marriott, Hilton, Hyatt, IHG and Accor.

Why are hotels important to New Zealand?

Hotels are key infrastructure in New Zealand's tourist economy, sitting alongside our airlines, airports and physical transport networks such as road and rail. Why is this infrastructure – our "tourism backbone" – so important?

The tourism backbone is comprised of large-scale, capital-intensive, network businesses and government-owned infrastructure. Consequently, these assets are sensitive to construction/labour costs, changes in interest rates, and weaknesses within the network. Very few countries can *quickly* add new airlines, airports, transport networks or hotels to their nation's tourist offering – development timelines are long and returns are typically generated over extended timeframes, not during one or two good seasons.

For an isolated island nation such as New Zealand, a thriving tourist economy requires us to first market and sell "the New Zealand experience" to high-value international tourists *while they are still overseas*. The tourism backbone is a central element of those offshore marketing and sales efforts, even if we sometimes take it for granted. In competition with other global destinations, we must (1) encourage high-value travellers to visit New Zealand, (2) convey them by air to our country, (3) process them through our borders, (4) ensure they have somewhere comfortable to stay, (5) facilitate their safe and efficient movement between accommodation and attractions. Once this "guest journey" has been completed, international tourists *are ready to be sold to on a local basis by New Zealand's myriad smaller tourism businesses.*

Tourist destinations around the world are consciously and subconsciously assessed and compared on the relative strengths of their tourism backbone. *What's the airline like? How safe and easy is it to get around? How good are the hotels?* New Zealand is blessed with fantastic scenery and natural resources. However, without the right kind of tourist backbone, we cannot leverage those natural advantages to attract high-value international tourism.

About Hotel Council Aotearoa

Hotel Council Aotearoa (**HCA**) is an advocacy-focused organisation with a mission to educate and influence key decision-makers on matters of importance to the New Zealand hotel industry. HCA's target membership encompasses hotel owners, general managers, operators/brand companies, consultants, academics, advisors and other organisations and individuals having a close professional connection with the hotel industry. HCA currently represents over 140 New Zealand hotels, comprising over 15,600 guest rooms or 5.6 million available room-nights per annum.

To learn more about HCA or to become a member, please visit www.hotelcouncilaotearoa.com or email admin@hotelcouncilaotearoa.com.

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