CHAPTER 6

International hospitality market entry

Chapter objectives

After working through this chapter, you should be able to:

- Identify the major international market entry modes adopted by hospitality enterprises
- Understand the advantages and disadvantages of the various non-investment management arrangement (NIMA) methods
- Explain the criteria for changing international hospitality enterprises' entry modes

Introduction

Hotel companies try to achieve competitive advantages through various methods, one of which is their choice of mode of market entry. This chapter will present the rationales behind six popular foreign market entry modes, introducing you to the wholly owned subsidiary, joint venture, strategic alliance, franchising, management contract and consortia approaches. We will then compare their advantages and disadvantages. This chapter will discuss how several leading hospitality companies have chosen their international market entry strategies.

With the increasing competition in the international hospitality industry, large companies are beginning to realize that they have to compete in all the world markets for their products in order to survive and develop. It is therefore important for multinational hospitality companies to reflect upon the benefits of entering foreign markets. We would suggest that usual considerations include:

- Business growth: When growth opportunities become limited in the home market, companies are often driven to seek new international markets. A mature fast food product or standard hotel service with restricted growth in its domestic market often has new life in another country where it will be in an earlier stage of its life cycle.
- International branding and recognition: Loyal customers will use the same brand when they travel around the world.
- Economies of scale: Big companies can achieve these with higher levels of productivity and purchasing power, for example, lower per-unit cost in global advertising campaigns.
- High competitiveness: Multinationals can access more resources when entering foreign markets and attract labour from within the global human resource pool.
- Incentives: Governments in countries seeking new infusions of capital and technological know-how often provide incentives to attract multinational corporations.

Types of foreign market entry strategies in the hospitality industry

There are six major foreign market entry methods favoured by hospitality companies. They are:

1. Wholly owned: When a company undertakes the development themselves, including buying land, building the hotel/restaurant and operating it all as part of their company.
2. Joint venture: This refers to the creation of a partnership between a domestic company and a foreign company for the purpose of jointly developing and managing hospitality operations.
3. Strategic alliance: This is when companies are tied together by a common reservation and marketing system.
4. Licensing/franchising: Essentially licensing permits a company in the target country to use the property of the licensor. Franchising is when the franchisor (parent) grants to the franchisees the right to use the parent's name, reputation and business skills at a particular location.
5. Management contracts: A contract is drawn up between a management company with an established reputation and a property owner, who then runs the property for the owner for the return of management fees that have been agreed between both parties.
6. Consortia: Hotel consortia represent affiliations through membership of an association. These organizations primarily offer membership services to hotels for a fee.

We will now consider the implications of the different approaches.

Wholly owned subsidiary (by foreign direct investment)

The desire for partial or full ownership outside the home country drives the decision to invest. Foreign direct investment (FDI) describes the investment flows out of the home country as companies invest in or acquire plants, equipment or other assets in the target country. FDI allows companies to produce, sell and compete locally in key markets.

The main advantage is that they allow tight control for the parent company. The main disadvantage is that they are costly to set up and require detailed knowledge of local conditions. FDI involves the transfer of resources including capital, technology and personnel. It may be made through the acquisition of an existing entity or by the establishment of a new enterprise. The following example shows how the Accor group expect to benefit from the direct investment to build hotels in one foreign market.

Example: Direct investment in Polish hotel market

Poland's largest hotel chain operator Orbis, part of the French Accor group, is complaining that the weak euro and strong competition are biting into the company's profits. The answer lies in the building of a new cheap hotel chain next year. An appropriate investment programme will be started within the next few months. "We want to enter the segment of cheap hotels. We plan to create a chain of about 20 one-star hotels first in the towns where we don't have any other hotels. This concerns, among others, former provincial capitals, such as Gorzow", said Krzysztof Gerula, a member of the company's management board.

Source: Accor (2005), www.accor.com

Some hotel chains that owned their own hotels decided that due to rising costs, it would be better to dispose of their properties and concentrate on the operational side. Such as in February 2006, The Youth Hostel Association (YHA) was to sell 32 of its 227 properties across England and Wales in a bid to reduce its £34 million debt. The disposal followed a 12-month review by the charity's Board of Trustees.

Joint ventures

Joint venture is a direct investment that two or more companies make and share the ownership. The key issues to consider in a joint venture are ownership, length of agreement, pricing, technology transfer, local firm's capabilities and resources, and government intentions.

A typical joint venture is where two partners come together and take 50% responsibility each for running the new venture.

The advantages of joint venture are:

- Easier access to other countries' markets.
- Sharing of risks and costs. A company can limit its financial risk and exposure to political uncertainty.
- Achieve synergy by combining different value chain strengths. One company with in-depth knowledge of a local market might find a foreign partner possessing well-known brands.
- Finally, a joint venture may be the only way to enter a country if governments favour local companies, and impose high tariffs on foreign investment or regulate the level of foreign control that is acceptable.

The disadvantages of joint ventures are:

- Conflicts of interest may occur. The partners may not have the same priorities and the organizational culture may be very different.
- Partners must share risks as well as rewards.

- A company incurs significant costs associated with the control and coordination issues of the joint venture.
- One of the companies may lose control over its know-how and therefore could establish a potential rival.

ACTIVITY

Why did McDonald's choose the business form of joint venture when they first decided to move into Moscow?

Example: Fairmont Hotel and its joint ventures

Fairmont Hotels and Resorts (FHR) is one of North America's leading owner/operators of luxury hotels and resorts. FHR's managed portfolio consists of 83 luxury and first-class properties with more than 32,000 guestrooms in Canada, the United States (including the world famous "Plaza" in New York City), Mexico, Bermuda and Barbados, and in recent years has acquired properties in London, Monte Carlo and Dubai.

FHR was founded in 1907 by sisters Tessie and Virginia Fair, whose first hotel was opened in San Francisco. In 1999 Canadian Pacific Hotels and Resorts acquired Fairmont Hotels and FHR was born. FHR is a growth organization, and uses its brand of luxury and its strong reputation to establish a global presence. The company also has sound financial stability and because of this they are able to extend their brand into expensive sites away from North America.

FHR, in current years, have begun to enter international markets.

- The Fairmont Dubai, United Arab Emirates: The opening of the Fairmont Dubai through the joint venture, in July 2000, was the first investment in the hospitality sector in Dubai, if not the United Arab Emirates, by an international hotel operator. It was also the first investment of the joint venture and the first strategic opportunity to grow the FHR brand name.
- In a recent expansion into Europe, FHR headed into a joint venture with Kingdom Hotels and the Halifax Bank of Scotland. The venture, announced on 22 December 2004, suggested that they were to invest in luxury hotels in key European markets, with a potential buying capacity of £800 million.
- Fairmont Monte Carlo, Monaco: The European joint venture's first investment was the purchase of the Monte Carlo Grand hotel in Monaco, a 619-room landmark property on one of the most coveted stretches of the Côte d'Azur. The property was opened in March 2005. The agreement marked another important milestone in FHR's mission to extend its global market. The position of the hotel, the first in Europe, is well placed; Monte

Carlo is an expensive, superior and luxurious city, and shares these traits with the Fairmont.

- The Savoy, London: The acquisition of the Savoy, by FHR was completed in January 2005, again through the joint venture. Although the hotel was bought by Saudi Prince Alwaleed Bin Talal, the acquisition was through the prince's Kingdom Hotels International trust. FHR has the management rights to the hotel, in which the prince has a 5% stake. The acquisition of the Savoy was an important move for FHR, as they are keen to target the British market. The Savoy is one of the most recognized hotels in the world, subsequently FHR have entered the British market with the best.

Source: Fairmont Hotels and Resorts, www.fairmont.com

Joint venture partners may come from different industries and the new venture can gain synergies from the agreement. The following case provides an example of this synergy with partners from fashion companies joining with some of the hotel industry's biggest brands.

Example: Italian luxury goods producers in the hotel business

An interesting exercise in cross-branding has occurred with the entry of several Italian jewellery and fashion designers into the boutique hotel business. These ventures generally have taken the form of an alliance with an existing hotel company or a property developer.

One of the most highly publicized of these alliances is the Marriott-Bulgari link-up announced in February 2001. According to the plan, Bulgari, the Rome-based jeweller, and Marriott International have invested $70 million each into a joint venture hotel operation called Bulgari Hotels and Resorts. The hotels will be managed by Marriott's wholly owned luxury brand subsidiary, Ritz-Carlton, but will focus on Bulgari's luxury brand image, featuring Italian cuisine, furnishings and amenities. Although, originally, the initial units were supposed to be opened in London and Southern California, the first hotel is in fact to be inaugurated in Milan during the second half of 2003. The property, which is secured by a 10-year lease, offers 52 rooms and suites and includes a lush 4,000 square metre garden. In the medium term, Bulgari expects to create a portfolio of hotels worth US $800 million, with sales amounting to $300 million by 2008.

Similar news was announced in early 2003 between Rezidor SAS, the licencee of Carlson Companies hotel brands in Europe, the

Middle East and Africa, and the well-known Italian fashion house, Cerutti. The aim of this joint venture is to develop a new "lifestyle" hotel brand with the goal of capturing the "fast-growing, stylish, mid-market". This plan is to roll out designer rooms, bars and restaurants of an Italian genre, as well as the occasional spa.

Source: www.marriott.com and www.rezidorsas.com

Strategic alliances and global strategic partnerships

A strategic partnership is an agreement between two or more competitive multinational enterprises for the purpose of better serving a global market. In contrast to a joint venture where the partners may be from different businesses, companies in the same line of business almost always form the strategic partnerships. The Hilton Hotel Corporation and Hilton International is a good example. These two companies shared the name Hilton, although each was totally independently owned, they formed a strong strategic alliance from 1997. They join together in:

- worldwide promotion and development of the Hilton brand;
- sharing the same loyalty programme, HHonors;
- participating in each other's hotel projects;
- developing a worldwide mid-category brand name, Hilton Garden Inn.

On the 29th of December 2005, Hilton Hotels Corporation announced an agreement whereby it will acquire the lodging assets of Hilton International for approximately £3.30 billion (or $5.71 billion) in an all-cash transaction.

Strategic alliances exhibit three characteristics:

1. Participants remain independent after the formation of the alliances.
2. Participants share the benefits of the alliance as well as control over the performance of assigned tasks.
3. Participants make ongoing contributions in technology, products and other key strategic areas.

A partnership is a quick way to develop a global strategy without incurring any great costs. Reasons for forming alliances and partnerships include:

- Providing access to national and regional markets.
- Providing learning opportunities.
- Enabling companies to share costs for a project.
- Resolving lack of skills and resources within a company by forming an alliance with a company with those resources.

Despite the positive benefits of these opportunities, strategic partnerships have some disadvantages especially as the partners share control over the

tasks, which creates a series of new management challenges. There are also potential risks associated with strengthening a competitor from another country.

Case: Starbucks' Market Entry Choice

In order to enter the international markets, Starbucks used three methods of market entry as part of their global strategy. This was implemented through:

- wholly owned subsidiaries,
- joint ventures,
- licensing.

Wholly owned subsidiaries

The company-owned operations accounted for approximately 85% of net revenues in the fiscal year 2003. This highlights the importance of the company-owned operations and reinforces the need for these subsidiaries to be located were the company is familiar with the market. Consequently, the majority of Starbucks company-owned stores are located in USA, UK and Australia. The cultures are similar within these countries and Starbucks can concentrate on the markets they know, whilst taking part ownership in the markets they are unfamiliar with. In doing this all the net revenues will go directly to the company.

Joint ventures

US companies such as Starbucks have been forming joint ventures with international partners at a growing rate of 27% annually since 1985. This highlights the popularity of this mode of entry into international markets. Joint ventures enable the company to enter another country with fewer assets at stake, thus experiencing lower risk. In addition, the parent company's expertise and local knowledge can be joined together.

Companies having business agreements with Starbucks must be able to contribute to their mission. To ensure correct selection, Starbucks has set standards that potential international partners must comply with. These are the following:

- shared values and corporate culture;
- strong multiunit retail/restaurant experience;
- dedicated human resources
- commitment to customer service
- quality image
- creative ability, local knowledge and brand-building skills;
- strong financial resources.

In the early 1990's Howard Schultz was interested in the Japanese market. However, he was advised that Japanese people would not want to walk around with a paper cup of coffee and would not like the non-smoking environment. Despite a tough economic environment and advice from consultants Mr Schultz and his team went ahead to open up their first store internationally. In 1996 they entered the Japanese market when they formed a joint venture with Sazaby inc. forming "Starbucks coffee Japan limited". A joint venture was an ideal mode of entry for Starbucks, as the potential popularity of their product was unknown. The joint venture allowed Starbucks to be involved in the Japanese market whilst continuing to specialize in the

market where they were most competent in the US. The joint venture proved advantageous for both the companies. For Sazaby it gave them the opportunity to generate more sales and greatly increase their customer base. For Starbucks the alliance created lower risks for entering the new country, and insights to local knowledge.

Sazaby inc. is a well-established company in Japan known for creating brands in dining, clothing and households goods for over 30 years. The two companies combined their marketing skills and know-how to develop a new type of coffee store, customizing coffees and offering new lifestyle concepts. The companies also share similar corporate values. The expertise in coffee making and coffee bean sourcing provided by Starbucks, along with the local understanding of the Japanese market and ability to pinpoint locations from Sazaby, has created a clear market leader.

Stores have expanded rapidly since 1996 and now there are over 500 outlets in Japan (Levy, 2005). In July 2003 the new store in the Nagano prefecture broke the worldwide first-day sales record. The products they have created have been received enthusiastically by the Japanese customers, increasing domestic competition and greatly expanding the market for other coffee chains.

Licensing

Starbucks predominately have company-owned stores in the USA, but in certain circumstances Starbucks enter into licensing agreements. This is when companies provide access to real estate which would otherwise not be available, such as airport locations, national grocery chains, major food service corporations, college and university campuses and hospitals. As part of these agreements Starbucks receives licence fees and royalty fees.

International company-owned outlets now account for less than half of establishments overseas in 2003, whilst in 1999 company-owned operations was the most popular choice. This shows that Starbucks have modified their strategy to use the "shared risk" market entry modes, such as licensing agreements and joint venture as they are a safer choice in unknown markets.

Source: Starbucks (2006).

ACTIVITY

When are multinational enterprises, likely to use an international joint venture? When would they opt for a strategic partnership? Defend your answer.

Non-investment management arrangements

In recent years, there has been a move away from direct investment and leasing to non-investment management arrangements (NIMA) as the form of enterprise that is preferred by hoteliers and caterers. Franchising (licensing), management contract and consortia are three of the most important choices used by the hospitality industry.

Licensing

Franchising is one kind of licensing; therefore we first have a look of what a licence is. According to Rugman and Rodgetts (2003), a licence may be defined as a contractual arrangement in which one firm (the licensor) provides access to some of its patents, trademarks or technology to another firm in exchange for a fee or royalty. Licensing is an attractive alternative to direct investment when the political stability of a foreign country is in doubt or when resources are unavailable for direct investment.

Franchising

Franchising in the hospitality industry is a concept that allows a company to expand more rapidly by using other people's money than if it had to acquire its own finance (Walker, 2004). The franchisor grants certain rights, for instances, to use its brand, trademark, signs, operating systems and procedures, reservation system, marketing plan, purchasing discounts and so on for a fee. In return, the franchisees agree by signing the franchise contract to operate the hotel, restaurant and so on in accordance with the conditions set by the franchisor. Franchising is a way of doing business that benefits both the franchisor, who wants to expand the business rapidly and the franchisee, who has financial resources but lacks the specific expertise and recognition.

Franchising origins are in Bavaria, but it has been adopted by various types of businesses in many countries. For example, McDonald's generates 47% and Coca-Cola 80% of their income from international franchising operations.

There are currently over 2,500 franchise systems in the United States with more than 534,000 franchise units. This represents 3.2% of all businesses, controlling over 35% of all retail and service revenue in the economy. Two main types of franchise have been identified, they are:

1. Product and trade name franchise: An example of this is where Coca-Cola agrees to sell its syrup and the right to sell its trademark to independent bottlers (Franchisees).
2. Business-format franchise: This involves trademarks and products but marketing strategies, quality control, operating and interchange between the franchiser and the franchisee. This type of franchise is common in the hospitality industry. Examples include McDonald's, Holiday Inn, Subway and KFC.

Franchising in the hospitality industry began from 1907, when the Ritz Development Company franchised the Ritz-Carlton name in New York City. Holiday Inns also used franchising strategy to grow its size and popularity in America in 1950's and 1960's. About the same time, a new group of budget motels emerged. Motel 6 in California slowly spread across the country, as did Days Inn and others. It was not until 1960s that Hilton, Sheraton and other brands began to franchise their names. Franchising was the primary growth and development strategy of hotels and motels

during 1960s to the 1990s. However, franchising presents two major challenges for the franchisor: maintenance of quality standards and avoidance of financial failure on the part of the franchisee (Czinkota and Ronkainen, 2002) (Table 6.1).

Table 6.1 Companies that franchised the most hotels, 2002

Hotel company	Hotels franchised	Total hotels	% of hotels franchised
Cendant	6,513	6,513	100.0
Choice Hotels	4,664	4,664	100.0
InterContinental Hotels	2,834	3,333	85.0
Hilton Hotels Corporation	1,721	2,084	82.6
Marriott International	1,612	2,557	63.0
Accor SA	897	3,829	23.4
Carlson Hospitality	813	847	96.0
US Franchise System	494	494	100.0
Société du Louvre	366	900	40.7
CHE Group plc	314	372	84.4

Source: Hotels Magazine.

As we can see from this table, franchising is the most frequently used form of hotel brand development, as it requires little investment on the part of the international hotel chains whose main expenses are for marketing and managing their affiliates. The challenge for a hospitality franchisor is to maintain uniform standards across all franchisee units in the network. If one hotel does not keep the brand's standards, it damages the image of the whole group. Except for the risks cited above, franchising is a low risk endeavour from the point of view of a chain, since the franchisees carry virtually all the investment and business risk. According to Mintel (2005a) International Hotel Industry, Mintel International Group Limited, an average franchise contract has a duration of 10 years, although a few can go to 20 years or even longer. Franchisees pay an initiation fee when they join the brand, which is typically around $35,000 depending on the size of the hotel. Later, on a yearly basis, the franchisee pays royalty and marketing fees to the chain. The royalty fee, which is a payment for the right to use the brand name, varies from 3% to 7% of rooms' revenues, with an average of 4.3% for the American hotel industry. Marketing fees, ranging from 1% to 4.5% of rooms' revenues are calculated separately as they are split from the general revenues of the chain, and should be spent exclusively on the marketing of the hotel brand. Other franchising fees may include a charge for the use of the reservation service, typically amounting to 1.5–2.5% of rooms' rates. Franchisees also need to fund the loyalty programmes by paying into the system a few dollars for each night a programme member stays in their hotel. When customers redeem their loyalty programme points by staying at one of the chain's hotel for free, the fund reimburses the hotel usually at its average rate.

As a method of distribution, franchising provides many opportunities for growth and profitability. However, when considering a franchising relationship, both parties should carefully evaluate the alternative forms of ownership and operation. The individual goals and objectives of each party have to be weighed against the trade-offs of a franchisor–franchisee relationship. In essence, franchising is a strategic alliance between groups of people who have contractual responsibilities and a common goal. By choosing to invest in a franchise operation, an owner is expressing the belief that they will be more successful using someone else's business system rather than investing their own money in an independent operation and developing their own business system.

Case: InterContinental's Market Entry Choices

InterContinental Hotels Group owns, manages, leases or franchises, through various subsidiaries, more than 3,500 hotels and 534,000 guestrooms in nearly 100 countries and territories around the world; 2,983 of their hotels are franchised which contribute to 53% of InterContinental Hotels Group overall profit per year. Therefore the management of the franchising strategy is particularly important for the InterContinental Hotels Group Company, especially in the international hotel market and to achieve their corporate strategies.

InterContinental Hotels Group Finance Director, Richard Solomons, pointed out the main advantages of franchising to the InterContinental Hotels Group: "(a) capital to fund the brands' expansion primarily provided by third parties, (b) faster unit growth to achieve scale, (c) high barrier to entry business, (d) need scale to drive high relative returns for franchisees and (e) spread of ownership brings motivated owners and reduces InterContinental Hotels Group exposure to any one owner".

InterContinental Hotels Group need to make sure that, with the large number of franchised hotels that they own, relationships with the franchisee does not create potential for conflicts and does not lead to the failure of some franchised operations. InterContinental designed-specific policies that would overcome problems associated with management relationships, such as: (a) providing the correct level of training that will ensure the same standard operational procedures are adopted in all the hotels and (b) to ensure that all the hotels receive enough capital so they do not carry too much debt too early.

On 10th March 2005, InterContinental Hotels Group agreed to sell 73 of its UK hotels for £1 billion to consortium LRG Acquisition; however InterContinental would continue to manage the hotels they have sold. This strategic move ties in with InterContinental's strategy of shifting from outright ownership to become, instead, a broadly based hotel management and franchised hotels group. Finance Director Richard Solomons said: "This is a significant step forwards in the execution of our strategy and we have achieved attractive management contracts".

Source: www.ihgplc.com and news.bbc.co.uk

According to Beid and Bojanic (2006) and Nield (2003), franchising has its advantages and disadvantages as a market entry method.

Many companies are choosing to expand their operations using the franchise approach because of its advantages. The advantages for the franchisor include:

- The franchiser can expand internationally, at far greater speed and with much reduced capital investment.
- One impact of this rapid expansion is the realization of cost economies from operating at a higher level of volume. The company will get better prices on supplies and be able to allocate fixed costs over a larger number of units, bringing down the average cost, such as global advertising and purchasing.
- The franchiser does not need to do day-to-day management. Franchising motivates franchisees to work for themselves. The franchisers also save payroll cost.
- The franchiser may not want to take too many risks. The franchisor is able to diversify the risk of doing business.
- The franchiser receives income from initial fees and royalties. They also generate profits from equipments and supplies.
- The franchisees play an important role in the selection and retention of employees. Franchisees are always motivated by the system.
- Franchise owners are very careful to monitor the performance of the franchise because they benefit directly from the profitability of the unit.

There are also a few disadvantages associated with being a franchisor.

- Difficulty of controlling franchisees. This may be easy to control in the home country but may be extremely difficult in other countries. Even though operating standards and procedures are written into the agreement, they are not always followed.
- There is a trade-off between risk and return. The sharing of risk and ownership results in the sharing of profits as well.
- Government or legal restrictions may mean that a franchise cannot operate in the way that it wishes to. Franchisors are also easy targets for legal actions, such as antitrust suits and class action suits. Also, injury claims are prevalent in many service industries. For example, McDonald's has been sued by obese people who accused the fast food restaurant of causing their weight problems.
- Re-developments of products and the franchise package are not easy. Cultural differences make franchisers think about how to adapt their products and services before they move into other countries.
- There are difficulties in the coordination of the global and the regional management. Franchising offers less flexibility to managers.
- Protection of trademarks and copyright in foreign market is another contentious issue.
- Finally, recruitment of suitably qualified franchisees may be a problem in some countries. Franchisees may not have the necessary qualifications or attitudes to run a successful franchise unit in the product or service category.

Because of the problems outlined in the above discussion, it has been suggested that franchising may become more common in the slightly later stages of new market development, especially in developing countries.

There are many advantages to joining an existing operation rather than starting from the beginning. The benefits for franchisees include:

- First, there is an established product or service with a brand name and an identity in the marketplace. Franchisees get a proven business system and avoid having to learn by trial-and-error.
- It is normally very costly and time-consuming to build a brand image in the hospitality industry, while the importance of the brand name appeal is enormous. KFC franchisees have many more opportunities than other fried chicken shops to survive in a new foreign market.
- Franchisees benefit from the franchiser's experience and they also receive technical and managerial assistance from the franchisor. Franchisors transfer the knowledge they have accumulated as they progressed through the learning curve, thereby accelerating the process for franchisees.
- Franchisees benefit from the quality standard that is already in place for the franchise. There is a system of controls that guide the operations and provide for a certain level of quality and consistency.
- There is often less of a capital requirement for opening a franchise unit relative to the start up costs for an independent operation. Franchises have a track record that can be used to estimate demand, design the facility, schedule employees and order inventory. Franchisees also save cost because of franchise's centralized buying power.
- There are opportunities to expand the business within the region. Franchisees are usually given guidance of site selection and some form of territorial rights to add units based on demand. Franchisees also have better access to financial assistance compared with independent business.
- Franchisees can benefit from the franchisor's national or international advertising programme. An independent restaurant would not be able to afford to place advertisements in major magazines or during prime time TV shows.
- Finally franchisees have been proven to have a much greater chance to survive compared with independent business.

There are also some disadvantages to becoming a franchisee.

- First, there are franchise fees and royalties that must be paid in return for the benefits just described. These expenses are normally a percentage of sales and result in a decrease in the profit margin.
- Franchisee must follow the standards and procedures in the agreement. This restricts the franchisee's ability to control the whole operation in that certain requirements regarding products, service, price ranges and expansion are imposed by the franchisor.
- Some franchisors provide unsatisfactory training programmes and other supports.

- The problem of market saturation. There are more than 600 McDonald's in London.
- It is very complicate to terminate the agreement if the franchisee would like to change brands or sell the business.
- Finally, the franchise's reputation and image can be negatively affected by the performance of individual units.

Case: Franchising In Fast Food Industry – Subway

Description of operation: Subway, the world's largest submarine sandwich franchise offers a reasonable well-structured franchise programme. Our concept is low investment, simple operation and delicious healthful fast food. Number of franchised units: over 20,000 restaurants in 73 countries.

Number of company-owned units: 1
In business since: 1965
Franchising since: 1974
Franchise fee: $12,500
Capital requirements: $86,300–$213,500
Financing options: Third party

Training and support provided: Two-weeks training with 50% hands-on and 50% classroom. Continued support from headquarters and development agents.

Subway was once again named the top franchise opportunity by entrepreneur, a US-based business magazine. By the year 2010, Subway continues to grow globally and intends to have opened a further 7,500 Subway restaurants opened outside Canada and the USA. To do this Subway has thought up a well-structured franchise programme. This involves keeping the start-up costs low and the operation efficient and uncomplicated.

There is a simple three-step process to opening up a franchised property of Subway. There are opportunities to open franchises up all over the world. The first step is to research into the company and decide if it is the right company or not. Subway has put together a whole range of resources like a brochures and online seminars to work through the opportunities available. The next step is to apply and fill the application in, this is also available online. The last step is to look into applying for investment to fund the operation.

Franchisee is responsible for including, finding the location, funding, hiring and operating of the restaurant, etc.

Subway's franchise fee is $12,500, while Burger Kings fee is $18,000 and McDonald's is $45,000.

Source: Subway, www.subway.com/StudentGuide/, www.franchises-4u.com/restaurant.asp and www.totalbusiness.org.uk/adetail.aspx?codeP=1542

Management contracts

The use of business management contracts dates back to the time of the British Empire and its colonies in 19th century. The concept was later developed in the United States and then re-exported to the rest of the world. This type of contract emerged due to an absence of professional training in many sectors (Cunill, 2006). A business management contract can be defined as a contract under the terms of which a company agrees

to manage another one, on behalf of and at the risk of the latter, in exchange for financial remuneration (Sharma, 1984). Other authors, such as Pérez Moriones (1998), define hotel management contracts as an agreement between a hotel management company and the company owning the hotel, under the terms of which the management company runs the hotel. The owner normally does not make any operational decisions but is responsible for providing the necessary capital and for meeting the payment of construction expenses and debts. The management company receives a fee for its services and the owner receives the remaining profits after all costs have been deducted.

The hotel industry is where management contracts are most widely used. InterContinental Hotel, which was set up in 1946 as a subsidiary of Pan American World Airways, began to run some of its Latin American hotels under management contracts in the 1950s. With the increasing cost of land, construction costs and mortgage interest rates from the 1970s, investment on the large properties became very expensive and risky. The management contract was becoming popular because of the way it transfers the investment risk from the hoteliers to the property owners. This type of management contract also allowed hotel chains to expand rapidly in domestic and international markets, achieving greater economies of scale and global branding impacts.

Property investors now have accepted the fact that management skills and brands are some of the main ingredients needed for successful hotel operations. Therefore it is better for them to turn to a hotel management company to run the property instead of attempting to do this themselves. In many situations, even before a new hotel is built, an agreement is made for the management contract. This enables the hotel management company to give advice and consultancy on important issues, such as location, room design, leisure facilities and decoration. The management company also need to start parts of their activities well before the hotels' inauguration, such as recruitment, training and marketing.

Nield (2003) argues that management contracts are the best method of market entry when the contractor possesses management know-how and the owner of the hotel wants no part in the day-to-day operation of the business. He defines the management contract as an agreement where one company (A) runs a hotel or other enterprise for another company (B). Therefore, management companies (A) offer:

- brand image for example, Hyatt Hotel;
- operating standards;
- management systems for consistency;
- staff recruitment, training and management;
- reservations and referral capabilities.

The other company (B) receives:

- profit;
- new markets;
- financial safety.

	Management companies	Investment companies
Advantages	Fast chaining: Hotel management companies can develop much faster using this method with very limited risks. Financing the property: The management companies need a little or no initial investment. The reduced risk: The risks for management companies running the hotel deriving from excess building costs, market recessions or changing markets are all significantly reduced. High return on investment (ROI). Due to the low amount of investment required from hotel management companies, very high financial and economic earning can be achieved.	Reduced risks in running the hotel business. Generally, minimum profit is guaranteed and the capital investment will be paid back With the recognition of a prestigious hotel brand name, the value of the property may increase
Disadvantages	Obtaining only part of the profits. Loss of the propertys potential appreciation. In the past 5 years, in many parts of America and Britain, property prices have more than doubled. The owners may interfere despite the contract in some of the management issues, limiting the management companies' operational potentials. Management companies may lose the contract in certain stage.	Lost control of daily operations of the property. The management company may not have the necessary experience, knowledge or resources in managing overseas' business.

Figure 6.1 Advantages and Disadvantages for management companies and for investment companies

At first most companies operating in this area were sought after as they offered the hotel owner a form of "insurance" based on their expertise or "know-how". This allowed the management contractors to dictate the terms of the contract, so that they might charge:

- a percentage of revenue;
- a percentage of profit;

- fees for group services for example, marketing;
- additional fees for reservations system.

There are some advantages and disadvantages for both the management companies and property owners (Nield, 2003; Bowie and Buttle, 2004; Cunill, 2006) (Figure 6.1):

Early stage management contracts were completely one-sided, benefiting only the management company. The management company's business profits were implicitly guaranteed via a fixed basic fee that was paid regardless of the real profits, meaning that management companies did not need to worry about the costs of the business (Cunill, 2006). However, the 1980s brought about an end to this, as the number of companies operating in this field brought about competition, which in turn changed the nature of the contracts. This situation has now changed so that the client can decide many terms of the contract. Typically, a management contract may contain guaranteed profit, penalties for underperformance, profit sharing, a fee and a share of profit. Property owners can even ask the management company to contribute a certain amount of capital, for example, towards the pre-opening costs and the initial working capital required for the development. Some financial contributions to the business can involve a strategic alliance between the owners and the management company.

At the moment, competition between hotel chains means that owners can be more selective. Cunill (2006) pointed out, that generally speaking, large international hotel chains have more specialist management skills and better reputation in the field, while many new small- or medium-sized specialist management companies have also been formed without huge overhead. They also provide more flexibility in contracts and operations. These small- or medium-sized management companies tend to have a short-term contract from 1 to 10 years.

Case: A Small Industry Example

Marshall Management, Inc. a leading, mid-sized hotel management company, today announced that it has signed seven new management contracts with two separate ownership groups. The new contracts raise to 15 the total number of hotels Marshall Management has been selected to manage this year to date in 2004.

Six of the seven hotels are owned by Independent Property Operators of America, LLC (IPOA), a real estate investment group. The seventh property – a Holiday Inn Express currently under construction in Kent, Ohio – is owned by a private investment group and is expected to open in April 2005.

The six-hotel IPOA portfolio includes four Comfort Suites and a Hampton Inn & Suites, all located in Northern Indiana and a Comfort Inn in North Carolina.

"We have a long history and proven track record of operating hotels in the Midwest", said Michael Marshall, President of Marshall Management. "These hotels are well located, and we intend to immediately install our proprietary marketing and management programmes to further enhance their profit potential".

Marshall Management, founded in 1980, has special expertise in operating three- and four-star branded hotels and resorts, averaging 100 to 400 rooms, in urban and central business districts, suburban/drive-to and resort locations. In addition, the company has a proven track record managing independent resort properties. Located in Salisbury, Md., the company has managed a wide array of leading hotel brands, including Hilton, Sheraton, InterContinental Hotel Group, Choice and Cendant. Additional information about Marshall Management may be found at the company's website: www.marshallhotels.com

Source: 7 October 2004, Magna Hospitality Group, Business Wire.

International consortia

This far we have considered the big players and their international presence but what about the independent hotels? How can they compete in international markets against the multinationals? The answer is that there is a way and that is to join an international hotel consortium. Nield (2003) explained that an international hotel consortium is a collection of independent hotels in many countries that come together to combine their resources. These hotels cooperate to gain specific corporate benefits through economies of scale from purchasing, trading and marketing activities (Roper, 1997). The well-known hotel consortia include Best Western, Golden Tulip, Logis de France and leading hotels of the world.

Case: Distinguished Hotels International To Launch

Distinguished Hotels International (DHI), a new marketing and management consortium of more than 150 independent hotels around the world, will officially launch in London November 8–11 during World Travel Market 2004. The company will be headquartered in New York and will operate sales offices in New York and London. The creation of DHI represents the merger of UK-based Grand Heritage Hotels International with DHI in the United States, which features seven hotels managed by the Magna Hospitality Group LLC. The new company will offer corporate and leisure travellers a prestigious collection of luxury properties in the UK, Ireland, mainland Europe, Africa, the West Indies and North America. Each hotel is described as "uniquely different" with exceptional amenities and significant architectural and/or historical features. DHI's formation reunites William F. Burruss, who founded and served as President of Grand Heritage Hotels International until the company was sold in 1997, with Timothy Hadcock-Mackay, the current owner and CEO of Grand Heritage Hotels International in Europe. As President, Burruss will handle the day-to-day operations for DHI, and Hadcock-Mackay will serve as Chairman, focusing on new hotel membership. "We will offer leisure and business travellers a 'one-of-a-kind' travel experience with very high standards", said Burruss, who also serves as Chairman of Magna Hospitality. "They will be able to choose from a list of more than 150 independent, luxury hotels, castles,

chateaux, stately homes, resorts, and health spas and inns located around the world. Unlike chain hotels, each DHI property – whether city centre or resort hotels – will be unforgettably unique, offering the top-quality guest amenities and architectural elegance for which Grand Heritage has always been known". Although DHI will manage some of the properties, its central role out of the New York sales office will be to market its hotel affiliates to potential visitors, including leisure travellers, business travellers, company executives, government dignitaries, celebrities, and meeting and trade show planners.

Source: www.distinguishedhotels.com

In the hospitality industry, consortia are typically found in the hotel sector but there is also some evidence of their activities in the restaurant market. Hotel Consortia represent affiliation through membership. These organizations primarily offer membership services to hotels for a fee. Nield (2003) explained that the consortia offer:

- Reservations systems, for example every Best Western hotel immediately link to their centralized reservations system.
- Referrals systems: Note how on KLM flights you are offered accommodation with Golden Tulip.
- Purchasing: The power of the consortium may equal the power of the chain. The consortium may negotiate discounts for its members because of large purchasing power.
- A full marketing package: Including brochures and full travel arrangements. Best Western has packages with the travel agency Going Places.
- Sales offices in major cities worldwide.

Example: Best Western BestRequests™ standards

Best Western is the biggest hotel brand in the world and it is a hotel consortia. Best Western hotels are independent, but they all keep the same BestRequests™ standards:

- dataports in all rooms;
- free high-speed Internet access[e];
- free local calls under 30 minutes[a];
- free long distance access[a];
- complimentary in-room coffee/tea makers[b];
- 50% non-smoking rooms[c];
- hairdryers in every room;
- iron and ironing board in every room[b];
- complimentary toiletries available upon request – that is razors, shaving cream, sewing kits, toothpaste;
- guestroom TVs offering at least one English language channel with international news;
- bottled or canned water available on-site, 24-hours-a-day;

- photocopy facilities available on-site for hotel business travel needs during normal business hours;
- king-size beds available in a minimum of 10% of rooms[d];
- clocks in all guestrooms;
- music provided in all guestrooms (e.g. clock radio);
- bottled shampoo.

Implementation of BestRequests® October 2001 in US, Canada and Caribbean; January 2002 in all other countries.
[a]US and Canada only due to telecom services and tariffs
[b]In-room or on request outside of the US, Canada and Caribbean
[c]20% outside US, Canada and Caribbean
[d]Queen-size bed outside US, Canada and Caribbean
[e]North America only

Source: www.bestwestern.com

Which method of entry should you use?

Douglas and Craig (1997), suggest that the way in which a company enters a market acts as a signal of the organization's behaviour and defines how the organization will do battle with its competitors in the future. While Doole and Lowe (2001) note that the way in which a company enters an international market depends upon several factors, for example, their organizational objectives; the financial resources available; the competition within the market; the nature of the product or service being offered; and the host country's resources, staff and political and legal systems. Nield (2003) argues that it depends on the distinctive competency of the company that is, what is it that the company is good at that gives it its competitive advantage. If a company has a distinctive competency that is easily copied it will require control and would therefore need a method of market entry where the competency is not given away. On the other hand, if the company's distinctive competency cannot be copied it could utilize a "looser" method of market entry. In general, top companies whose distinctive competency is technological knowledge should think about the benefits of entering the market as a wholly owned subsidiary. Specifically, companies whose distinctive competency is specialized management should consider the benefits of entering the market with a combination of franchises and subsidiary operations.

Example: Cendant signs franchise deal for Russia

Cendant Corp.'s Hotel Group today announced the signing of a deal with Hermitage Hospitality Ltd. to franchise Days Inn®

hotels in Russia and the other 14 countries of the former Soviet Union. The lodging franchise agreement covers the nations of Estonia, Latvia and Lithuania as well as all 12 countries that make up the Commonwealth of Independent States: Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

Finally, the choice of one or more entry strategies will depend on the following:

1. the critical evaluation of the company's resources and capabilities;
2. the critical business environmental factors in host country;
3. the advantages and disadvantages that each choice would make to the overall vision and objectives of the company.

When it comes down to a choice of entry method for a particular hospitality company, there are more specific factors relating to that company's situation that must be taken into account. These include:

- ✓ capital,
- ✓ company size,
- ✓ branding,
- ✓ management skills,
- ✓ local knowledge,
- ✓ human resources,
- ✓ costs.
- After the full consideration of these factors, some entry strategies will be seen to be no longer appropriate. Managers will then decide between equity (wholly owned or joint venture) and non-equity-based alternatives (NIMA) recognizing that both present different risks and returns.
- Entry strategies need to be conceived as part of a well-designed business strategy. International strategic formulation requires a long-term perspective and it needs to match other functional strategies within the organization as well.

ACTIVITY

Which market entry method should Subway use if they want to entry Vietnam market? Why?

Chapter case study: Marriott International

The first Marriott Hotel was opened in 1957 in Virginia, USA. Previous to this Marriott had evolved from a root beer stand opened in 1927. After continued expansion the company name changed to Marriott Corporation in 1967. This accelerated growth strategy continued into the

1990s with the acquisition of the Ritz-Carlton Hotel Company, Renaissance Hotel Group and ExecuStay corporate housing company. The acquisitions allowed Marriott to enter new markets with an immediately strong position and now Marriott International operates and franchises more than 2,600 hotels and resorts around the world. They operate in North America and in Asian countries, such as China, Japan and South Korea. In Europe, France, Germany, UK, and Latin America and Caribbean.

Their long-term goal is to have a presence in every gateway city, major resort destination and high-demand suburban market around the world. In the USA, they manage or franchise approximately 8% of the total lodging market; outside the USA, they represent only 1%.

Marriott Hotels are operated using a variety of different types of ownership. Many are owned and operated by Marriott International. For example in 2003 they added 185 new hotels and timeshare units with over 31,000 new rooms. Approximately one-third of this room expansion was from conversions to Marriott brands by owners and franchisees of competitor brands.

Also in their plan to reduce the capital intensity of the business, Marriott is planning to increase the number of joint venture partners for new resort developments and by broadening their marketing and sales agreements to include resorts developed by others.

Joint venture has also been a successful market entry mode for Marriott International. At the end of March 2005, they completed a 75% investment with their joint venture partners courtyard. This investment is said to be accelerating pace of renovations and upgrades in the joint venture hotels. Thus also helping to further expand the Courtyard brand's industry-leading preference and generate even higher returns on investment, as stated by Arne Sorenson, Marriott's Executive Vice President.

Another way of strategy that Marriott uses is to buy and build properties and then sell them with an operating agreement, doing this they make money from the property and also from the right to use their brand.

In addition to the market entry modes mentioned above Marriott operates wholly owned hotels and strategic alliances. The global strategic alliances offering promotional and database marketing programmes which have been of no or little cost to Marriott. The partnerships are with:

- 23 airlines;
- financial services companies, such as Amex and VISA;
- consumer brands including AT&T and Hertz.

Within the UK, until recently, Marriott Hotels were operated as franchises by Whitbread PLC. This method of ownership is used all over the world as it allows Marriott to enter new markets with reduced risk, even within the USA Marriott Hotels are operated as franchises by third parties, such as White Lodgings. Further to this a 50:50 joint venture has been set up with Whitbread to run the Marriott properties within the UK, however this is a temporary measure whilst the hotel stock is sold on. After this the hotels will be operated under long-term management contracts. Marriott relies on the prominence of their brand to sustain this growth and support the methods of entry they use.

Despite their size they are still looking for new markets to move into. At the beginning of 2005 it was revealed that Marriott are "looking for a second partner with which to expand its Courtyard by Marriott chain in the UK". Whilst it was also revealed that "buying a budget

hotel franchise – to compete against competitors, such as Accor's Ibis – remained an option". This shows that their motivation is often to be more competitive.

Overall Marriott International has successfully used many of the market modes of entry to attract and retain customers internationally.

Source: Caterer-Online (2005) and www.marriott.com

Conclusion

We have seen how in the real world, the international hospitality market situation is always complex and decisions can become complicated. We have studied the following market entry methods:

- whole-owned subsidiary,
- joint venture,
- strategic alliance,
- licensing or franchising,
- management contracts,
- consortia.

Our review of the activities of most of the significant players in the international hospitality industry has demonstrated that they fall into one or more of these categories. For instance, an owner may manage some of their own hotels, manage others which do not belong to them, or have varying amounts of majority or minority shareholdings in properties which they manage. To make the final decision about international entry, hospitality enterprises need to review their competences and the host countries' facilities and resources. This will be undertaken using analytical techniques, such as those elaborated in earlier chapters and set within an understanding of the cultural dynamics of those markets. The final decision will be part of the organizations strategic review and we will address this process Chapter 7.

Review questions

1. Why do companies choose to invest in an international market?
2. What factors lead them to select between the various options outlined in this chapter?
3. How would you justify advising a company in terms of the levels of risk involved in the various options?
4. If you enter a market without local knowledge what could the consequences be?