

INVESTMENT TODAY



EVALUATING THE VALUE OF A BRAND

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Stephen W. Brener, our regular finance columnist, cedes his space this month to Peggy Berg, an expert in hotel market analysis and a widely published author.

Brand impact—the business an existing hotel in a chain loses when a new hotel comes into that chain—has been a hot topic on the lecture circuit for about five years.

Impact is important, but it's actually a side issue. What really matters are franchisee-franchisor relations and brand value.

A specialist in consumer research told me recently that brand loyalty requires brand consistency. If this is the case, few hotel brands command loyalty, even though some have name recognition and 800-number service, with appropriate advertising support available to replace customers lost to attrition and bad experiences. The challenge for each franchisor is to position product so it promotes brand loyalty.

While the mix of services franchisors offer has been changing and, in some cases, diminishing, franchise fees have been rising for some brands. Not surprisingly, franchisees who are courted by many brands and who face changes in relationship with their current franchisors are questioning terms and value.

Oddly, while franchise charges vary little among major brands such as Holiday Inn, Hampton Inn, Comfort Inn and Days Inn, the value delivered is very different. With the proliferation of franchise salespeople and the push to increase the size of each brand, fewer hotels are ready to change flags, and franchisors are more competitive than ever.

For now, adjustment is being made through the negotiating process, but a restructuring of franchise fee arrangements to reflect the relative merits of each brand is likely within the next few years.

Meanwhile, impact has become a significant bargaining chip for such incentives as an early out, royalty reduction in case impact occurs, and future franchise licenses. Franchise administration phone conversations often sound as much like tryouts for amateur theater as business office talks. Regardless, some fundamental differences remain. Imagine the following exchanges:

◆ The franchisor says it is vital for the brand to expand for recognition and referral. "True, but not in my backyard," responds the franchisee.

◆ The franchisor says the brand must offer its customers consistent quality. "Yes, but make someone else renovate," counters the franchisee.

◆ The impact each hotel sustains effectively contributes to the overall success and expansion of the chain, the franchisor claims. "On the one hand, my hotel can't afford to contribute, so don't impact me," the franchisee replies. "On the other hand, the hotel I want to bring into the chain would only cost that other franchisee's hotel three points of occupancy...."

While franchisor and franchisee share some business goals, there will always be two sides to the impact issue. To complicate matters, franchisor and franchisee tend to change sides depending on circumstances.

The length of franchise contracts is also an issue now, following the demise of the 20-year management contract. We see franchise companies frequently under different ownership, major market changes and uncertainty about a chain's long-term ability to deliver business. As a result, it isn't prudent to sign a 20-year contract to give away nine percent of gross revenues unless both sides have a predefined way to execute a "divorce." Periodic windows, negotiated termination charges to leave the contract and other versions of exit provisions are emerging.

An Iowa law that sharply restricted franchising to protect existing units from encroachment has temporarily been softened, but anti-encroachment legislation is pending in other states and on the federal level. So far, the mediation/arbitration option has been a nice diversion, but neither franchisee nor franchisor seems to take it seriously. Both prefer to bargain directly with each other, rather than trust the outcome to fate and to the judgment of a mediator.

Times are changing fast. The shakeout of the past five years is nearly complete, and a new era of hotel franchising will emerge in the next two to four years. **LH**



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