



RUSHMORE

## UNDERSTANDING FRANCHISE FEES

Every two years HVS evaluates the fees charged by hotel franchise companies in the United States. The purpose of this analysis is to provide a comparative review of various brands based on 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 an affiliation against the total cost of such a commitment.

When evaluating a potential 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. 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 application, plus continuing fees paid periodically throughout the term of the agreement.

Payment of continuing franchise fees begins when the hotel assumes the franchise affiliation and usually continues 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 is 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.

### LOOKING AT EACH CLASS OF HOTEL / LEAST AND MOST EXPENSIVE

#### Economy Class

Least Expensive	Budget Host	0.1% OF ROOM REVENUE
Most Expensive	Days Inn	12.6% OF ROOM REVENUE

#### Mid-Rate Class

Least Expensive	Best Western	2.9% OF ROOM REVENUE
Most Expensive	Holiday Inn Express	11.8% OF ROOM REVENUE

#### First Class

Least Expensive	Historic Inns of America	0.6% OF ROOM REVENUE
Most Expensive	Westin Hotels	15.0% OF ROOM REVENUE

#### 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. These services generally include consulting, purchasing assistance, computer equipment, equipment rental, on-site pre-opening assistance and marketing campaigns.

To provide a comparison of franchise fees, three tables were developed from information presented in the documents prepared by the respective franchisors. Each

table assumes a different class of lodging facility (i.e., level of quality), so that comparisons can be made between brands of a similar class. The HVS franchise fee models (one for each class) assumes a new hotel which opens, 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.

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 and termination provisions 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 see the full charts referenced above,** check out the story online at [LHonline.com/development/franchising/rushmore\\_franchise\\_fees\\_0909/](http://LHonline.com/development/franchising/rushmore_franchise_fees_0909/). To obtain a free copy (\$750 value) of the HVS 2009 U.S. Hotel Franchise Fee Guide send Steve an e-mail at [srushmore@hvs.com](mailto:srushmore@hvs.com).

\* **Stephen Rushmore** is president and founder of HVS, a global hospitality consulting organization with offices around the world. Steve has provided consultation services for more than 12,000 hotels throughout the world during his 35-year career and specializes in complex issues involving hotel feasibility, valuations, and financing. He can be reached at [srushmore@hvs.com](mailto:srushmore@hvs.com) or 516 248-8828 ext. 204.