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HVS Monday Musings: The Dichotomy between Management Fee and Franchising Fee in India

October 25, 2020 / By Akash Datta , Dipti Mohan

Asset-light operating models have become the main stay for growth of many of the major hotel companies in India, with Management Agreements being the preferred structure. The other major asset-light model – Franchising - though is yet to gain significant traction in the country. Approximately 14% of the total brand signings in 2019 were franchised properties as compared to 10% in 2018. On the other hand, Management Agreements accounted for 76% of the total brand signings in both 2019 and 2018. In contrast, hotel franchises are the most popular model in mature markets like the US, where almost 80% are franchised.

In the past, hotel operators' reluctance to grow through the franchise route has been attributed to the following issues:

1. Poor adoption of standards by hotel owners because of lack of experience in the sector,
2. Low (or no) availability of good quality third party management firms,
3. Management Agreements provide a larger revenue generating opportunity.

Herein lies the dichotomy: In many instances the net management fee (base and incentive Fee combined) is either less or at par with those of Franchise Fees – which, we find, are often not very well negotiated. A key reason for such a dichotomy is that managed hotels in India often suffer from lower Gross Operating Profits (GOPs), due to a combination of low Average Daily Rates (ADRs) and smaller key counts than in most other parts of the world. The relatively lower GOPs consequently impact the amount of earnings from the incentive fee. As a result, the overall management fee (including base fee and incentive fee as a percentage of revenue) are often lower or at par with Franchise Fee. The food for thought here is that the operator's responsibility and engagement is significantly higher in a Management Agreement than a Franchise Agreement and should therefore be earning a higher fee.

Summary

Franchising provides an efficient growth model with lower risk for both hotel brands as well as asset owners, but it has still not gained significant traction in India. Read on to know more.

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We believe that the sector should look at resolving this dichotomy. Hotel owners and operators should consider evaluating the franchising option more seriously.

Franchising provides an efficient growth model with lower risk for both hotel brands as well as asset owners due to distribution of responsibilities amongst both parties. It helps in bridging the gap between the brand's growth plans and the owner's concerns on cost of fee paid to brands/operators.

Franchising helps brands to expand their presence quickly, especially to smaller cities and remote locations without incurring substantial recurring capital costs, all-the-while allowing hotel owners more control over day-to-day operations of the property. Franchising truly brings with it the most indispensable attribute of a hotel company, its brand. Add to this the well-established distribution channels, loyalty program affiliation and the related sales & marketing initiatives make Franchising a compelling option.

As per a recent report by Grant Thornton, India, in general, is the second largest franchise market after the US and several sectors, such as retail and restaurants, have used franchising successfully for expansion. It is time for hotel operators to implement best practices followed by the allied sectors, including using technology and forming partnerships with third-party asset managers to promote faster growth. Brands must look to correct this conundrum and seriously evaluate the Franchising option.

About Akash Datta

Akash Datta, HVS Senior Vice President - Consulting and Valuation, leads consulting engagements, encompassing market studies, feasibility studies, strategic planning, valuation, and forecasting. Akash has spent nearly 13 years in the hospitality industry having successfully worked with International Hotel and Consulting firms such as Hilton, JLL and HVS in South Asia and the Middle East. In 2005, Akash started his Consulting career with HVS as an analyst following which he undertook his MBA in International Hospitality Management with concentration in Real Estate Finance from IMHI ESSEC in Paris, France. Known for his industry insights, Akash works with leading companies, private clients, industry groups, and global networks. Contact Akash at +91 989 9517 404 or .

About Dipti Mohan

Dipti Mohan, Vice President - Research with HVS South Asia, is a seasoned knowledge professional with extensive experience in research-based content creation. She has authored several 'point of view' documents such as thought leadership reports, expert opinion articles, white papers, and research reports across industries including hospitality, real estate, infrastructure, cement, and construction. Contact Dipti at .