



Sustainability challenges and opportunities arising from the owner-operator split in hotels



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ABSTRACT

The hotel industry is often thought of as something of a laggard in the implementation of sustainability initiatives. In this conceptual paper, we examine this assertion in a new context: models of hotel ownership and operation. We focus on current trends in the latter toward 'asset light' ownership/operation configurations, materializing in so-called hotel management contracts. It is established that whereas hotel management contracts usually favor the control and manage paradigm, add additional stakeholders and encompass stakeholder detachment, these characteristics of a separation of ownership and operation actually hinder instatement and application of the values-driven collaborative learning processes needed to further sustainable development. Finally, the need to follow up this conceptual discussion with empirical research – focusing on validating, refining and/or adding to the three key issues identified here – is highlighted and key issues for future research are identified.

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1. Introduction

Sustainability or, more precisely, sustainable development has become established as a major global concern focused on issues such as the harvesting, utilization and renewal of natural and other resources, the effects of the release of waste and pollutants into the environment, and the distribution of wealth across different parts of the world and between generations. It has long been argued that this concept constitutes a challenge to all businesses including tourism and hospitality (e.g. Bramwell and Lane, 2012; Moriarty, 2012; Saarinen, 2006), but in the latter at least, implementation of relevant initiatives and solutions has proved to be partial and painfully slow (Melissen, 2013).

The discussion presented in this paper considers both generic and specific reasons for this, ultimately relating the issues arising to prevalent ownership constructions in the hotel industry, where ownership, operation and brand are often split between two or more parties.

Consequently, this is, in essence, a conceptual paper focusing on the (causal) relation between patterns of ownership and progress toward sustainable development. More specifically, it explores whether hotel management contracts are suited to facilitating the latter. Consistent with the proposition that there has been very little consideration of the relationship between ownership constructions and sustainable development in hospitality research, this paper aims to offer at least a preliminary map of key issues and consider obstacles to sustainability initiatives, and possible approaches to overcoming these. Through identifying and confronting crucial implications of the owner-operator split in managed hotels and the main reference points for realizing sustainable development, also through referring to literature in both fields, the discussion presented resolves these areas into a coherent framework that might be employed in future research.

The structure of the paper is as follows. The next section gives a thumbnail outline of recent trends in hotel ownership and management and is followed by a generic reflection on critical success factors in pursuing sustainable development in business. We then consider the specific research pertaining to sustainable development initiatives in the hospitality sector with a view, subsequently, to considering the implications of these issues for the paper's central question—namely how hotel industry ownership arrangements might bear on the ease or otherwise of pursuing sustainability in this sector. The final section presents some preliminary conclusions based on this conceptual discussion, but also, and especially, establishes key issues for future research.

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2. Hotel industry ownership arrangements

At first glance, hotel ownership seems a rather straightforward subject: large international chains with established brands and reputations are represented across the globe, normally with medium sized or large hotels and the balance of market supply is made up of mostly national or sub-national companies and/or independent properties, often well-rooted in the local community and owned by local investors. However, closer inspection reveals hotel ownership, and as a consequence governance, to be more complex, the result of strategic changes in the hotel industry that have gathered pace in the last two decades. In fact, one can theoretically discern five different stakeholders directly involved in ownership and operation of most chain hotels. They are:

1. the owner of the actual physical property (the building);
2. the owner of the land on which the physical property is located (where this is not the same as the owner of the physical property);
3. the person or business entity entitled to the hotel's profit, and bearing the business risk associated with that (for the sake of brevity, and to avoid possible confusion, we will refer to this as the ownership of the profit and loss);
4. the operator, that is the party running and managing the hotel; and
5. in case of a branded hotel, the owner of the brand.

In practice, these stakeholders combine in a number of standard configurations mostly referred to as 'owned-operated', 'leasing', and 'management contract/agreement' (Eyster and deRoos, 2009; Parkinson, 2006; Armitstead, 2004; Gannon and Johnson, 1997). In some of these classifications, 'franchising' is also included. However, franchising arguably constitutes not so much a configuration per se, but rather refers to the owner or operator using the brand of an established third party in return for which the franchisee pays the brand owner royalty fees (Field, 2006). As such, a franchise agreement can, but may not necessarily be, part of any of the three standard ownership configurations. These models can be elaborated upon as follows.

In the case of an owner-operated property, the property and profit and loss are owned by the same party that operates the hotel. An example of this could be the aforementioned smaller, independent hotels. In case the owner-operator decides to go the franchise route, that will obviously decrease the 'independent' status of the hotel in question, but as mentioned above, would still qualify as owned and operated. With a leased property, the owner of the physical property acts as a landlord and leases that property to the operator. The latter is also the owner of the profit and loss and will use either a proprietary brand (or no brand at all) or may choose to operate as a franchisee of an established brand. The lease can be either fixed or variable; in the latter case the rent is calculated as a percentage of either revenue or some level of profit, such as gross operating profit or earnings before interest, taxes and depreciation (EBITDA). A configuration not so well-known outside the hotel industry is the management contract. In one of the seminal works on this phenomenon Eyster and deRoos (2009: 5) define a management contract as:

... a written agreement between the owner and the operator of a [...] hotel by which the owner employs the operator to assume full responsibility for operating and managing the property. In general, the operator pays in the name of the owner all operating expenses from the cash flow generated from the property, retains management fees, and remits the remaining cash flow, if any, to the owner. The owner supplies the lodging property, including any land, building, furniture, fixtures, equipment, and

working capital, and assumes full legal and financial responsibility for the project.

From the operator point of view, the three ownership configurations discussed above represent decreasing levels of exposure to risk. That is, operators that decide to lease rather than own a hotel property no longer have to bear the risk associated with real estate ownership, but retain the operating risk, as the business, if no longer the physical assets, is still theirs. In situations with variable lease constructions the building owner shares part of the risk, as he stands to receive less rent in case of lower revenue or profit levels achieved by the operator. Moving from leasing and operating a property to solely managing it for an owner, operators almost completely divest themselves of the business risk of owning a hotel. Even when the property operates at an overall net loss, the operator might still be entitled to significant base, if no longer incentive, fees these being typically based on total revenues and gross operating profit, respectively.

The above-mentioned move is exactly the direction in which large multinational chains have been developing, by divesting themselves of hotel ownership. For example, the *Intercontinental Hotel Group* (2015) owns only 8 hotels, manages 767 and has around 4167 franchises over various brands. As *Roper* (2013: 1) notes (see also *Bader and Lababedi*, 2007; *Bender et al.*, 2008; *van Ginneken*, 2011; *Blal and Graf*, 2013; *Sohn et al.*, 2013):

Over the past 15 years the major multinational hotel companies have implemented an asset-light or 'virtual-hotel' business model which involves them divesting of owned and leased hotel properties and growing by franchising and managing hotels ... [.] The major companies have developed into multi-segmented and multi-branded chains in order to meet differing customer needs, to get around territorial exclusions and to adapt to country-level conditions.

Further, from the operator point of view, the management contract tends to be the preferred option for large international chains operating full-service hotels (DeRoos, 2010) and luxury high-end brands (Cunell and Forteza, 2010: 505). Franchising is the main and preferred method of expansion for hotel companies in economy and middle brand markets (Cunell and Forteza, 2010: 505).

In tandem with many hotel chains giving up ownership positions, the variety in types of ownership has increased (Singh et al., 2012). A non-exhaustive list of hotel investors would include high net worth individuals as well as a wide range of institutional investors: insurance companies and pension funds, private equity funds, real estate investment trusts, sovereign wealth funds or other government(-controlled) investors as well as operators that are not following the asset-light model.

In discussing the impact of ownership constructions on sustainability, the remainder of this paper focuses on management contracts, because the management contract offers the clearest separation of ownership and operation. It is also an agreement that is typical for and (pretty much) unique to the hotel industry, unlike leasing or franchising. Consequently, the management contract represents the logical starting point for analysing the impact of separation of ownership and operation on sustainability initiatives within the hotel industry.

3. The management contract and owner operator alignment of interest

Notwithstanding its popularity, the management contract model is not without its challenges. *Schlup* (2004: 332) notes that "it is quite obvious that, despite its popularity, the management contract is the most problematic of all operating concepts in the hospitality industry" while *Parkinson* (2006: 327) observes that

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