

ISSUES ABOUT THE INTERNATIONALIZATION STRATEGY OF HOTEL INDUSTRY BY MEAN OF FRANCHISING

Juan M. Berbel-Pineda

Department of Business Administration
Pablo de Olavide University
Ctra. de Utrera, km. 1, s/n, 41013 Seville
Spain

José M. Ramírez-Hurtado

Department of Economy, Quantitative Methods and Economic History
Pablo de Olavide University
Ctra. de Utrera, km. 1, s/n, 41013 Seville
Spain

Abstract

Actually firms know their market is the global market because local firms are competitors and everything outside of the frontiers is relevant to them. So, there are many reasons to the internationalization of a firm. Internationalization strategy is different between firms because it depends on firm activity. External presence is necessary for the hotel industry internationalization. An interesting strategy in hotel sector is the international expansion through franchising. In this work, we have made a descriptive study of the national and international expansion of Spanish hotel chains, but we have studied the franchise option. We have described franchising like an interesting expansion strategy. We have observed franchising is not one of the most useful internationalization strategies. Little international knowledge of Spanish franchisors can be one of the reasons.

Keywords: internationalization, entry mode, hotel, franchising.

1. Introduction

The phenomenon of globalization incites every company in the present to consider any other company of the world as a competitor. Thereby, for every company, not only local companies are competitors; in fact, everything that happens outside their borders is relevant. An important aspect to be considered when a company becomes international is the route of entry through which it decides to serve foreign markets (Brookes and Roper, 2011, Pla-Barber *et al.* 2011; Guillen, Garcia-Canal, 2010). The range of possibilities is very wide and diverse, with different action formulas depending on the parameters considered to be most important.

Therefore, the *route of entry* into a foreign market is one of the most critical strategic decisions that a company must face, since it will greatly influence its business success (Berbel-Pineda and Ramírez-Hurtado, 2005 and 2011; Young *et al.*, 1989). In principle, there are three generic ways of serving foreign markets, which are: through exportation, through licensing and/or performing own investments (Rothaermel *et al.*, 2006). Each one of these options involves, for the companies, differences in the degree of control exerted by the matrix on the external operation, the resources it must commit and the potential profit it may obtain (Buckley, 1995; Root, 1987). Sánchez and Pla (2003) indicate how, as the degree of control exerted by the company on the external operation increases, the assumed risk increases due to the increment of responsibility in decision making and to the greater resource commitment and, therefore, medium-term potential profits also tend to be greater. In contrast, the methods that involve a low control level minimize the assumed risk, but usually at the expense of medium-term potential profits.

In any case, for all the options, the degree of resource commitment and the level of assumed risk move in the same direction. The degree of control does not work this way, as it increases with commitment, while flexibility decreases. In general terms, the search for a greater control of the activities will require the company to commit a greater level of resources; this will bring the company a greater knowledge of the market, as well as a greater presence in it (Sánchez *et al.*, 2007).

Thereby, for this study, we will focus on the control exerted on the activities and on the level of resources committed by the hotel chain on the external hotel, as a distinctive criterion of the different *routes of entry*, and more specifically, we will show the different ways of entry used by the Spanish hotel chains, focusing our study on the *franchise* modality. As it is indicated by these last authors mentioned, the hotel sector is specially interesting for analysis, since: a) internationalization, given the high degree of consumer-supplier interaction, involves necessarily the physical presence in the target country, b) the different ways of entry of the hotel industry cover a wide range of possibilities (management contracts, *joint ventures*, acquisitions, franchises, wholly owned subsidiaries, etc.) and c) the different cooperative ways of entry have similar or greater importance for the company than the ways that involve total property.

This study is structured so that in a first section we focus on the franchise, firstly observed as a commercial system (definition, main characteristics, etc) and later analyzed from the point of view of hotel internationalization. And, in a second section, we explain the methodology followed and we then show both the results obtained and the conclusions drawn.

2. The franchising system

Many commercial formulas and business strategies have been denominated as franchises, being this denomination sometimes incorrect (Bermúdez, 2002). Defining the concept of franchise presents great difficulties, since depending on the perspective from which we face its study (legal, commercial, institutional,...) we will pay more attention to some aspects or other.

Franchise is a commercialization relationship between two agents - a franchisor and a franchisee - who are legally and financially independent but share a common target (Insa-Ciriza, 2003). A franchise is based on a contract by which the franchisor grants the franchisee the right to use a developed concept of business, including the brand, products, marketing services and methods, and the way to run the business, in a specific area, in exchange for a payment, as well as the inclusion of an operations manual, which is regularly developed and supervised by the franchisor. Usually, there are several franchisees in the channel that have a similar cooperation contract with the same franchisor, allowing them to work together in the market through a directed cooperation system. Article 62 of Law 7/1996, 15th January, on the Planning for Retail Trade in Spain, defines franchise as *the commercial activity carried out under an agreement or contract by which a company, denominated franchisor, transfers to another company, denominated franchisee, the right to operate its own commercialization system of products or services.*

Díez *et al* (2005) define franchise as *a cooperation system between different companies, linked by a contract under which one of them - the franchisor - grants the other company (or companies), denominated franchisees, in exchange for certain tradeoffs (payments), the right to exploit a brand and/or commercial formula materialized in certain distinctive signs, guaranteeing at the same time the technical support and the necessary regular services to facilitate such exploitation throughout the length of the contract.* From this definition, some franchise characteristics may be drawn:

- It is a cooperation system.
- The relationship between the parties is captured in a contract.
- The parties are: the main company or matrix, denominated franchisor, and the companies that sign the contract with the main company, denominated franchisees.
- The franchisor provides its franchisees with a brand, a commercial formula or “know-how” and technical assistance and support throughout the length of the contract.

Another definition is that of Bermúdez (2002). This author considers franchise as *a system of business cooperation with the aim of linking, in the long-term and contractually, two economically and legally independent parties, under which one of them (franchisor), bona fide, grants the other (franchisees) the right to exploit its business and the production, distribution and/or commercialization of the tangible and/or intangible products, of proven quality. These last are composed of main and additional services, protected (patents, brands...) and unprotected (“know-how”), all of them sufficiently tested, efficient and authorized by license. In exchange, each franchisee is bound to make different payments, periodic and/or single, direct and/or indirect, as a tradeoff to the granting of those rights, be them industrial or commercial.* According to this definition, six flows occur between the subjects of the contractual relationship, i.e. between the franchisor and the franchisee:

- a) *Information flow.* Information is necessary both between the franchisor and the franchisee, and between the franchisees themselves, facilitating problem solving, the transferring of data about market and competence, and the acquisition of training and services required by the franchisee.
- b) *Property flow.* The right to exploit a business, of one or several brands, target goods and services of the contract and specially the “know-how”, must be present between both parties,
- c) *Physical flow.* If a relationship for the exchange of tangible goods has been established between the franchisor and the franchisee, then physical flows occur between the members of the distribution channel.
- d) *Financial flow.* The franchisee must perform a financial tradeoff in exchange for the goods, services and ideas received from the franchisor.
- e) *Satisfaction flow.* Knowing the satisfaction of some of the parties - franchisor or franchisee - is important in view of decision making.
- f) *Fidelity flow.* The fidelity flow is important to maintain a lasting relationship between the parties.

From the business perspective, the franchise system is an alternative to create companies with lower assumed risk, as a consequence of repeating a proven successful management model. Thereby, franchise involves an expansion for business structures already established.

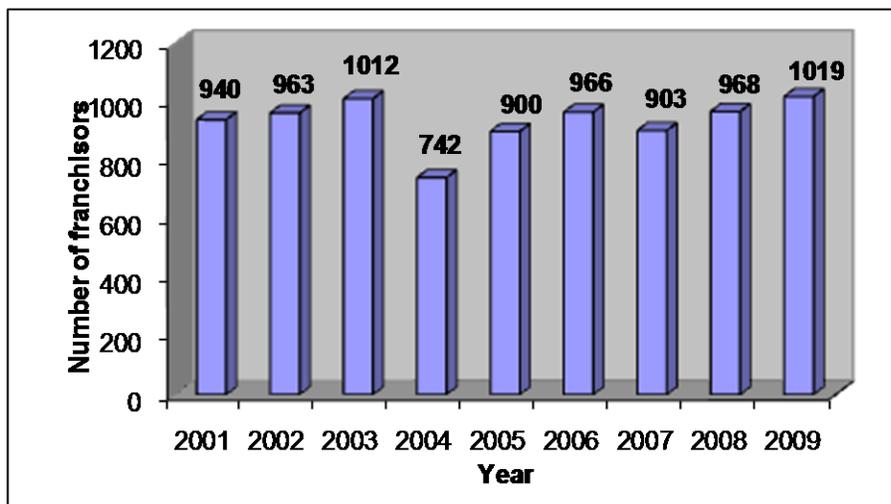
It is important to state that not every company or activity can be franchised. In order to take place, franchise requires the determinant keys of success, already proven by the franchisor, to be recognizable and transmittable to the future franchisee through an adequate training process. If this process is not carried out in the best way possible, the process of franchising a company will fail in the short or medium term.

3. Chain hotel internationalization: the franchise option

In the hotel sector, many establishments are linked to the chain through a great amount of contractual figures, such as franchises, management contracts and leases, etc. Franchise is a situation poorly observed in Spain, although frequent in other countries like France or USA (Fernández and González, 2006). In this case, the chain searches for a business associate (the franchisee) who starts an own establishment, but under the guidelines and brand of the company. The fundamental difference with the management contract lies on the fact that the exploiter itself is the one who runs the management of the franchised establishment. Thereby, in this case, the hotel chain only controls directly the reservations center and keeps some control of the brand.

In Spain, according to the consultant Tormo & Asociados, the number of franchise companies was 1019 for the year 2009, which means an increase of 5.27% (graphic 1).

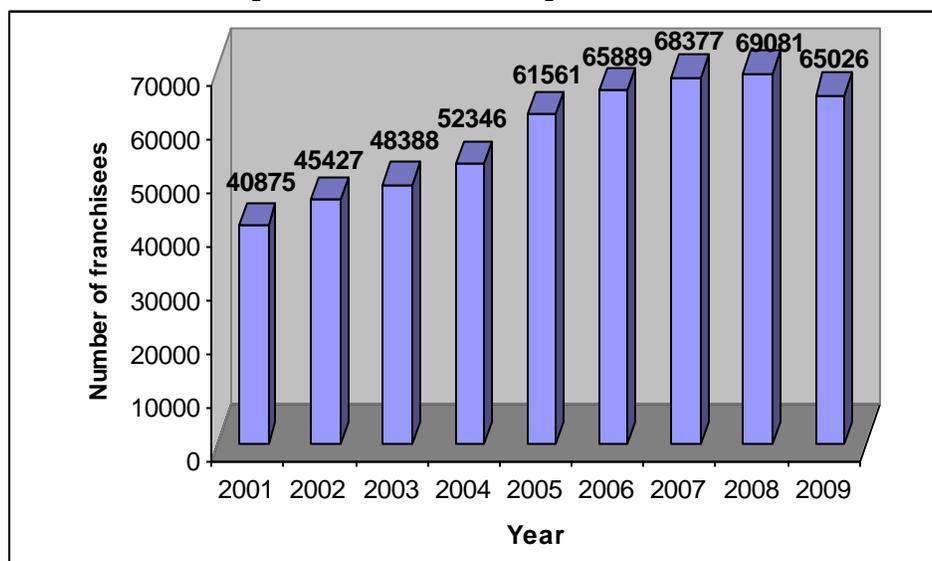
Graphic 1. Franchisors in Spain (2001-2009)



Source: own elaboration from Tormo & Asociados.

The number of franchised establishments, in contrast to the number of franchisors, has decreased, basically due to the closure of establishments as a consequence of the global economical crisis. Specifically, in the year 2009, there were 65,026 franchised establishments in Spain, which means a decrease of 5.87% compared to the previous year (Graphic 2).

Graphic 2. Franchisees in Spain (2001-2009)



Source: own elaboration from Tormo & Asociados.

According to the Spanish consultant Tormo & Asociados (2009), 15% of the Spanish franchises have already boarded international markets. This means that a total of 132 Spanish franchise companies have settled in 98 international markets. The main targets are the countries of the European Union. America is the second continent of choice for Spanish franchise companies from among the rest of countries in the world, since there are 60 companies settled in 23 countries.

As for the countries, neighboring Portugal leads the rank by number of present companies, with 89 chains and 1,557 business units. It is followed by the Mexican market, with 33 companies and 310 establishments, France and Andorra, both with 30 centers, although France has 999 establishments and Andorra has 39.

Despite the fashion is still ahead outside with almost 30 national concepts, there is an increasing number of sectors that bet decidedly on this strategy. Catering appears in a second position, with 20 chains.

In terms of hotel companies, it could be stated that the main motivation that leads small and medium hotel companies to integrate a franchised network is focused on two main aspects (Connel, 1997):

- The need for entering an international reservations system.
- Being part of a chain with greater international recognition and a more advanced technology.

Therefore, franchise is a very important strategy for the internationalization of hotel companies. In fact, eight of the ten most important hotel groups worldwide operate through hotel franchises, from which the cases of Cendant Corp. and Choice Hotels International stand out (Del Alcázar, 2002).

As for Spain, the representativeness of franchise in the hotel sector is still poor. The use of this expansion modality is not frequent, neither for both national and international expansion. However, some of the main Spanish hotel chains with international presence (e.g. the Meliá chain) do use, in some cases, franchise as a way of entry in some markets, either for strategic reasons or due to other reasons beyond the control of the hotel chain, like legal restrictions of the target market to foreign investment.

In 2009, there were seven Spanish hotel groups that used franchise among their ways to operate in other markets, different from the national market: Forte Hoteles, Barceló, Fiesta Hotels & Resort, HM Hotels, Grupo NH Hoteles, Riu Hotels and Sol Meliá. The distribution of franchisee units abroad are detailed in Table 1.

Table 1. Spanish hotel franchisee abroad (2009)

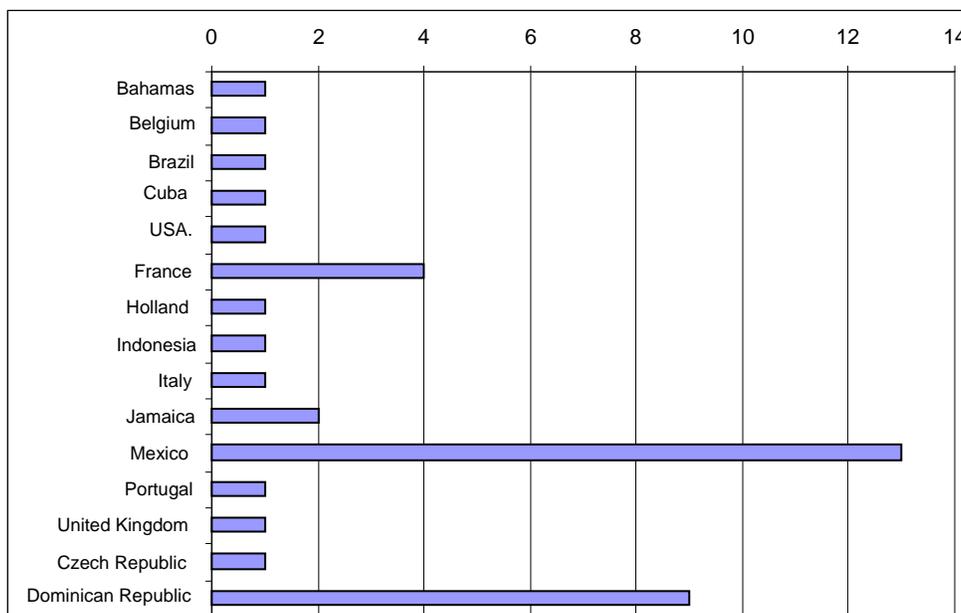
<i>Hotel chain</i>	<i>Franchisee abroad</i>
Fuerte Hoteles	1
Barceló	2
Fiesta Hotels & Resort	1
HM Hotels	1
Grupo NH Hoteles	3
Riu Hotels	22
Sol Meliá	9

Source: own elaboration.

We can observe that the chain Riu Hotels shows the highest number of franchisee establishments (22) followed by Sol Meliá (9) and the NH Hoteles Group (3).

As for the destinations chosen by each one of these groups to operate outside outside Spain, it must be mentioned that most of them operate in countries of Central America, where Mexico stands out with 13 franchisee establishments, followed with 9 by Dominican Republic. These two countries are followed by France, with 4 franchisee establishments of Sol Meliá. Also, despite the number of franchisee establishments is not very high, there is an important diversity of target countries (Graphic 3).

Graphic 3. Spanish hotel franchisees abroad by countries (2009)



Source: own elaboration.

In short, they are big hotel groups that use franchise among their different ways of international expansion.

4. Methodology

In order to perform this study, in which we show in a descriptive way how the international expansion of the Spanish hotel industry is being performed, focusing specifically on internationalization through franchises, we started from the total population of hotels outside and of the Spanish chains that have, at least, one establishment abroad. From initial information provided by the Secretary of State for Trade and Tourism, the Spanish hotel chains internationalized in the year 2006 have been identified. Once the chains were identified, the data base for our study was built up through the search of each particular operation, in secondary sources, basically the journals Editor, EditorLatino and Hostelmarket (which gather almost all the movements generated within the sector), complemented with the on-line information supplied by the chains and with diverse news from the press. This information allowed us to identify the characteristics related to each particular operation (way of entry, country, year, number of stars, hotel type, number of rooms, etc).

Finally, the information relative to the hotel chains was obtained from the yearbook *Hostelmarket*.

The period analyzed covers from the international operation perform in 1985 (Melia-Bali) until the end of 2006, gathering a total of 622 hotels outside, which belonged to a total of 47 Spanish hotel chains.

5. Results

With respect to the mode of entry chosen by the Spanish hotel chains for external operations (Graphic 4), we can mention that most of them are those which represent a greater control on the activities, that is, ways of entry based on direct investments (in freehold or through cooperation agreements). It is observed that the use of management contracts is the most taken mode in the Spanish hotel sector internationalization. With this, a specialization in the management aspect is pursued. The little use of modes like franchise or the shared ownership ways is stated. As it was marked out by Plá and León (2004), this may be due to the poor development of strong brands in the Spanish industry, recognized abroad, and the predominance of resort hotels, much more difficult to franchise due to problems of management and control of the typical activities of this type of establishments. Regarding the little use of modes based on shared ownership, these authors argue that it may be due to the scarce international experience of the Spanish hotel sector. It is estimated that, as the international experience increases, the mentality of the managers of the internationalized company will also increase, and they will show greater confidence at making local associates.

We must report again that the modes based on freehold are those which assume greater risk, due to greater capital requirements (although at the same time, this mode is useful for gathering greater control on the activities). That reason, as it was previously shown, makes the Spanish hotel companies search for cooperation modes, or contractual ways to develop their activities in foreign markets. Thereby, it is expected that, as this sector of activity gains international experience, and the brand image of our hotels grows, the choice for modes based on cooperation for the Spanish hotel industry internationalization will also increase (Table 4).

Table 4. Entry mode for national and international expansion (%)

ENTRY MODE	Freehold	Joint Venture	Management contract	Leasing	Franchising
National expansion	54.87	---	27.34	4.56	13.33
International expansion	22.34	9,00	53.21	8.02	8.23

Graphic 4: Entry mode for international expansion (%)



6. Discussion

We can state that most of the Spanish hotel chains use, for external operations, modes that represent a greater control on the activities, that is, ways based on direct investments (in freehold through cooperation agreements). In the Spanish hotel sector, it is observed that the use of management contracts is the most used mode. Franchise is a commercial formula that presents a high degree of maturity in many countries, as shown by the statistical data available on the subject, the organizations created to agglutinate franchisor groups, and also the laws for regulating the market, among other aspects. Big prestigious companies have used franchise within the last few years as an optimal way to reach new markets, since the assumed risk is much lower than in other trade ways. However, despite the spectacular advance experienced within the last few years in many sectors, there has been a minimal use of franchise as an internationalization strategy in the hotel sector. The poor development of strong brands in the Spanish hotel industry and the management and control difficulties shown by this type of establishments seem to be the most important reasons that lead to a minimal use of franchise as a strategy of the Spanish hotel industry internationalization. Until the year 2005, franchise was not very used in the internationalization of the Spanish hotel industry, due basically to the poor development of strong Spanish hotel brands, as well as to the management and control difficulties shown by this type of establishments.

These seem to be the reasons that led to a minimal use of franchise as an internationalization strategy in this industry.

However, from 2008 and until the end of 2010, there was a sharp increase of this mode of expansion in the Spanish hotel internationalization. In the stagnation within the last few years of new openings abroad, franchise may be a mode that allows the opening of new establishments abroad with a lower investment level. The consolidation of Spanish hotel companies around the world based on a proper “know-how”, as well as the increasingly strong brand “Spain”, makes the products and services of this country to be more recognized worldwide. Furthermore, in these times of shortage of financial resources and difficult access to them, the owners of these hotel chains are turning to modes that involve lower levels of investment in resources in order to accomplish the internationalization of their businesses, taking into account that the transference of the “know-how” is performed both for encoded assets and for services that are increasingly standardized in this sector, since, for the case of resort tourism, consumer behavior is increasingly homogeneous both in tastes and needs.

In summary, an important aspect in order to carry out an internationalization strategy is to create a powerful brand image. A high position of the brand will facilitate the existence of franchisees who desire to join a franchise chain. It is also interesting to search for management and control systems that are not difficult to implement, in order to prevent franchisees to flee.

References

- Bermúdez González, G.J. (2002). La franquicia: elementos, relaciones y estrategias, Ed. Esic, Madrid.
- Berbel, J.M. and Ramírez, J.M. (2011). Does the Foreign Market Entry Mode Choice Affect Export Performance? The Case of the Spanish Hotel Industry, *Journal of Business Economics and Management*, Vol. 12, No 2, pp. 301-316.
- Berbel, J.M. y Ramírez, J.M. (2005). La Internacionalización del Sector Hotelero Español: Evolución y Situación Actual de las Operaciones en el Exterior. *Cities in Competition*, Vol 3, pp. 125-140.
- Brookes, M. and Roper, A. (2011). The Impact of Entry Modes on the Organisational Design of International Hotel Chains, *Service Industries Journal*, Vol 30, No 9, pp. 1499–1512.
- Buckley, P.J. (1995). Foreign Direct Investment and Multinational Enterprise. Ed. Penrose.
- Connel, J. (1997). International hotel franchise relationships: UK franchisee perspectives, *International Journal of Contemporary Hospitality Management*, Vol 9, Nos. 5/6, pp. 215-220.
- Del Alcázar Martínez, B. (2002). Los canales de distribución en el sector turístico, Ed. Esic, Madrid.
- Díez de Castro, E.C., Navarro García, A. and Rondán Cataluña, F.J. (2005). *El sistema de franquicia. Fundamentos teóricos y prácticos*. Ed. Pirámide, Madrid.
- Fernández Barcala, M. and González Díaz, M. (2006). Elección de la forma organizativa en las cadenas hoteleras: el caso de Sol Meliá, *Papers de Turisme*, 39, pp. 25-43.
- Guillen, M.F. and Garcia-Canal, E. (2010). *The New Multinationals. Spanish Firms in a Global Context*. Cambridge University Press, Cambridge.
- Hostelmarket. *Anuario de la Hostelería*. Publicaciones Alimarket.
- Insa-Ciriza, R. (2003). Franchising in Spain: The success of being your own boss, *European Regional Review*, No. 39, pp. 58-61.
- Pla, J. and León, F. (2004). La Internacionalización de la Industria Hotelera Española: Formas de Entrada y Factores Determinantes, *Papeles de Economía Española*, No 102, pp. 193-206.
- Pla-Barber, J., Leon-Darder, F. and Villar, C. (2011). The Internationalization of Soft-Services: Entry Modes and Main Determinants in the Spanish Hotel Industry, *Service Business*, Vol 5, pp. 139-154.
- Ramon, A.B. (2002). Determining Factor in Entry Choice for International Expansion. The Case of the Spanish Hotel Industry, *Tourism Management*, Vol 23, No , pp. 597-607.
- Root, F. (1987). *Entry Strategies for International Markets*. Lexington Mass, Lexington Books.
- Rothaermel, F.T., Kotha, S. and Steensma, H.K. (2006). International Market Entry by U.S. Internet Firms: An Empirical Analysis of Country Risk, National Culture, and Market Size, *Journal of Management*, Vol 32, No 1, pp. 56-82.
- Sánchez, E. and Pla, J. (2003). Variables Estratégicas y Performance en la Elección de Modos de Entrada. Una Aproximación Empírica en Sectores de Prestación de Servicios. Actas del Congreso de ACEDE.
- Sánchez, E. and Pla, J. (2006). A Multidimensional Concept of Uncertainty and its Influence on the Entry Mode Choice: An Empirical Analysis in the Service Sector, *International Business Review*, Vol 15, No 3, pp. 215–232.
- Sánchez, E., Pla, J. and Herbert, L. (2007). Strategic Variables Influencing the Entry Mode Choice, *Journal International Marketing*, Vol, 15, No1, pp. 67–91.
- Tormo & Asociados (2009). www.tormo.com
- Young, S., Hamill, J. and Wheeler, C. (1989). *International Market Entry and Development: Strategies and Management*. Prentice Hall.