

# BE PREPARED WHEN IMPACT THREATENS YOUR HOTEL

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## Impact Threatens

Franchisors are constantly looking for opportunities to expand their chains. That is the nature of their business, and the strength of your chain also depends on its distribution. However, as a result, there are times when a potential new hotel entering a franchise system will take business from an existing franchisee. This is impact.

The major franchisors now notify franchisees that may potentially be impacted so the existing franchisee can express any concerns. If the potential impact is great, then the franchise application is generally denied. As a franchisee, you probably receive notification letters from time to time letting you know that your franchisor is considering an application in your area. When the property applying for a franchise threatens your business, you need to respond promptly and effectively. This article is written to help you respond.

Each franchisor has a series of procedures that you must follow to respond to an impact notification letter. These are spelled out in the impact policy for the chain, and are available to each franchisee. If a copy of the policy does not come with the notification letter, begin by calling your representative and getting a copy. In the meantime, you can follow the instructions in the notification letter.

## Responding to a Notification Letter

In most chains, if you have a concern, you can object to a franchise application by writing a letter. There is generally no charge associated with the objection. If the license is granted, subject to an impact study, and you decide to pursue the objection, then there may be costs to you. There are forms to complete if you decide to pursue a formal objection and an impact study and these forms are available from the franchisor.

## Commissioning an Impact Study

The franchisors typically have a list of authorized impact study consultants who can conduct these studies for you. The consultants are independent and do not work for the chains. They are selected because of their experience with this kind of analysis. Almost always, they are members of the International Society of Hospitality Consultants. This Society screens its members very closely for the quality of their work, their level of experience, and their ethics. There is a code of ethics for the Society and if a member is not independent in the work done for you, they can be censured.

Like most professionals, consultants charge for their time. However, you have the opportunity to

interview the consultants on the list before you select the company you will use. Take advantage of this free benefit and interview several consultants. Talk to them about their experience and also about your situation. If you have good information about your hotel and the prospective franchisee at the time you call, you can often discuss your situation with the consultant and get a good idea of whether or not it is worth doing an impact study.

## Procedures

Impact studies are based primarily on a series of interviews, tested for validity with research into other factors, such as reservation and operating statistics provided by a hotel chain, and economic and demographic information provided by sources such as a chamber of commerce. The primary interviews are with management of the existing franchisee hotel and the prospective new franchisee. These interviews are very detailed, particularly in the areas of market mix and demand sources, fill nights, and operating history. Generally, at least one other knowledgeable person is interviewed in order to test the validity of the information gathered from the applicant and existing franchisee.

## Subjectivity And Independence

Impact studies are subjective. Although a great deal of empirical data and a number of opinions are gathered, the conclusion is essentially the judgment of a single consultant. That consultant should be independent and make every effort to be thorough, fair, and honest. The plight of the existing franchisee is a sympathetic one, and the existing franchisee has the advantage of the natural sympathy of any consultant. This has to be the situation, because of the size of the hotel company compared to the size of the existing franchisee, who often represents a family business. In addition, the franchisor has to adopt a hands-off attitude with the consultant; providing as much information as possible, but in no way directly influencing the outcome of the study.

## Definition Of Impact

There are a couple of key concepts underlying impact studies. The first is the definition of impact:

Impact is business lost from one hotel to another. It has two parts. Base impact is business lost due to new rooms or newly competitive rooms (newly competitive rooms include rooms such as those renovated from an independent to an affiliated status which were not competitive as an independent, but may become competitive when renovated and affiliated). Incremental impact is lost due to brand. It can only be lost in four ways.

- Reservation system
- Directory
- Brand advertising
- Sign

Incremental impact does not include any business that would be lost if the impacting property were another brand. Incremental impact is the difference between the impact created when a hotel carries another brand and a hotel carries the same brand as the objecting franchisee (impact of a Days Inn on a Comfort Inn is base impact; impact of a Comfort Inn conversion if the existing franchisee is a Comfort Inn has both base and incremental components). Base impact is how much that Comfort Inn would lose to a Days Inn. Incremental impact is how much more it would lose to a Comfort Inn. Incremental impact has to be from one of the four sources listed above.

*Only incremental impact counts in an impact study under current impact policies.*

The second concept is the computation of impact. Impact equals the number of room nights estimated to be lost divided by the number of room nights available. It is important to remember that impact is based on room nights available, not on room nights occupied. This means that small hotels and high occupancy hotels have an arithmetic advantage in impact calculations. For example:

A 200 room hotel has 73,000 room nights available. Incremental impact of 5 points is  $0.05 \times 73,000$  or 3,650 room nights a year. If that hotel only operates at 50 percent occupancy, it has 36,500 room nights occupied each year so it has to lose 10 percent of its *occupied* room nights in order to have 5 percent impact.

A 60 room hotel has 21,900 room nights available. In this case, 5 percent impact is only 1,095 room nights. If that hotel operates at 85 percent occupancy, then it only has to lose 5.9 percent of its occupied room nights to reach 5 percent impact.

Remember that incremental impact, which is the important factor, only includes business lost that was generated by the franchise. In the first example, with the larger hotel, if the franchise only generates 10 percent of occupied room nights the hotel would have to lose all franchise generated business to reach a 5 percent impact hurdle and it may not be worth doing an impact study.

### Know Your Consultant

Impact estimates tend to be most realistic when the consultant is knowledgeable about the local market. Impact estimates also become more realistic when the consultant has a great deal of experience in doing impact analyses and has done these analyses for long enough to have seen a variety of situations evolve and become resolved.

Finally, studies are most realistic with consultants who really know the franchise system being studied. If the consultant knows Choice but not Holiday Inn, they may not be up to date on reservation delivery, the difference in guests between brands, different rates of no shows, different methods of counting denials, etc.

### Prepare for an Impact Study

If you decide to go ahead with an impact study, be prepared for the consultant. If you present good information, and assist the consultant in understanding the market, you will get the best report. These are the things you should know:

**Location/Distance:** Actually measure the distance between the two hotels.

**Market Sector:** In most communities, there are several different trading areas, such as the medical center area, the interstate, and downtown. Help the consultant understand what they are during the short field time that is available for fieldwork so the consultant can appreciate the overlap between your hotel and the applicant.

**Market Mix/Demand Sources:** The fundamental basis of an impact study is the question of overlap of demand sources. Impact is created when two hotels tap the same sources of business. The more detailed you can be about sources of business, and their seasons and timing, the better the consultant can identify and report on the business that you would lose due to impact. You should be able to explain to the consultant what business you believe will shift to the applicant hotel if it converts. You should also be able to explain why this business will be lost due to the applicant hotel sharing your brand (incremental impact) as opposed to general competition from the applicant (base impact).

**Competition:** One way in which market sector and overlapping demand sources are defined is by identifying hotels that compete with each other. Know which hotels are most competitive and why and also should know which hotels are not competitive. Impact tends to be larger when your hotel and the applicant are directly competitive.

**Reservations And Denials:** The reservation system's statistics are the only empirical measure available to estimate how much business will shift from one property to another. In addition, the reservations coming into an applicant through another system will generally have to be replaced through your system. Know how much net business comes through your reservation system and when it

occurs. It is important that reservation system data reported to the consultant be adjusted for actual room nights rather than shown as a gross reservations booked figure.

Denials are also an important figure, because when your hotel has denials, the assumption is that those denials will be absorbed to mitigate (reduce) impact. In most chains, denial figures are much higher than the room nights that could actually be absorbed. Know how much of your denial total occurs on peak nights (so it can't be absorbed), is at a very low rate, or is for a specific room type that may not be generally available, etc.

Seasons And Fill Nights: An applicant hotel that is operating at capacity will not have the space available to take business from an existing franchisee. Therefore, the number of fill nights at a hotel and its seasonal patterns of business are very important. If the applicant operates at a high occupancy and takes comparatively little from the existing reservation system, consider very carefully if an impact study is a good investment.

Capacity Available: The consultant computes the amount of capacity available at the applicant hotel in room nights, and that puts a ceiling on the amount of business that that applicant hotel can take from the you. Obviously, the ceiling has to be adjusted for seasonal business patterns and so on. The more available capacity, the more impact potential exists.

Rate: Hotels that are more than \$10 apart in rack rates tend to have little impact on each other. This is because of the customer profile of hotels shifts within about a \$10 price spread. Rack rates are important, as well average rates, since contracted business typically brings down an average rate, but is not generally subject to impact. Rack rates and rates through the reservation system, as well as posted rates on a sign, are those that are compared to each other in evaluating impact.

Mitigation: Although your hotel, an existing franchisee, may have the potential to lose a substantial amount of business through the system to an applicant hotel, that loss may be mitigated in terms of actual impact by your ability to replace the business from other sources. The consultant has a responsibility to look at your marketing program, pricing structure, and the availability of other business in the market, such as wholesale business or contract business, to see whether impact can be reduced through reasonable modification in management and marketing.

Properties/Facilities: Hotels that are very similar in facilities, such as two-story exterior-corridor down-and-out motels, have more potential to impact each other than when one hotel is a full-service hotel with meeting space and the other is a motel-type property. Different facilities tend to attract different guests. You should help the consultant to understand the differences in the facilities and also the demographic profile of your hotel and the applicant property.

Projection: The consultant will make a limited projection of occupancy and average rate at both the applicant and your hotel, generally based on projections made by you and the operators of the applicant hotel. You should be ready to discuss business potential for the next three to four years (project occupancy and rate).

### Conclusion

Estimating whether a hotel will be impacted a great deal, some, or not at all is relatively straight forward based on the information listed in the foregoing. Refining that estimate to one point in impact is highly subjective. However, that is the assignment given by the franchisor to the consultant and will be the conclusion of the study.

Impact policies have been change in response to interest and pressure from the franchise communities. They will continue to be in flux and chains need input from the hotel community. On March 2, 1994 there will be an Impact Forum held in Atlanta to discuss impact policies, impact studies and related issues. Your participation would be welcome.

*This summary has been provided by Peggy Berg and The Highland Group. We can be reached at (404) 872-4631 should you have any questions or wish to discuss an impact situation. Please also call us if you are interested in attending the Impact Forum.*