IN CHINA FRANCHISE

THE ULTIMATE GUIDE FOR
HOTEL FRANCHISE IN CHINA

2020 EDITION

PREFACE

THE purpose of this report is to understand the hotel franchise market environment in China by delving into the different market players, trend drivers, supply and demand influences, and legal environments.

In the present report the following topics are covered based on our understanding of the matter:

1. Understanding the difference in operation models – management, franchise, and third-party management;
2. The history of franchise – US and China;
3. The supply side of the things;
4. Fees and costs of the hotel franchise;
5. SWOT analysis of the franchise model;
6. Case studies of success and failure of franchise businesses;
7. The legal environment of franchise in China;
8. The next generation of hotel franchise; and
9. Franchise in Africa.

We hope this report can benefit both franchisees and franchisors, help to close the gap of expectations and understandings of the business, and contribute towards a more transparent and healthier hotel franchise environment in China.

ABOUT US

Alliance Hospitality a leading consulting and hotel management firm in the global hospitality industry. With the firm's hospitality experts, the team provides services around the world to support and shape investment strategies that deliver maximum proceeds along the entire lifecycle of the hospitality assets.

Alliance's services include but are not limited to:

- FS *Feasibility Study*
- OS *Operator Selection*
- DR *Design Review*
- PM *Project Management*
- PO *Pre-Opening Assistance*
- PR *Performance Review*
- OM *Operational Management*
- AP *Asset Appraisal*
- IB *Investment Brokerage*
- RP *Repositioning*
- REIT *REITs*

ABOUT THE AUTHORS

Karen Liu
Senior Director, Head of Project Development Service at Alliance Hospitality. Karen has extensive knowledge and experience in the hospitality industry in China and has led the company's project management team to execute many hotel research and development projects in the world.

Anna Vdovina
Director, Project Development Service Africa at Alliance Hospitality. With many years of international experience in the hospitality industry with brands such as IHG and Kempinski, Anna is now responsible for business development and project management in Africa.

Carlson Li
Analyst, Project Development Service at Alliance Hospitality. Carlson graduated from the master program of Surrey University England. Prior to joining Alliance, Carlson has gained operational background from many international hotel groups such as Hilton, Marriott, and IHG.

LEGAL EXPERT

Gary Zheng
Partner at Dentons.
Legal opinion in this report was kindly provided by Gary Zheng, partner and head of Hospitality and Entertainment Division at Dentons. Gary has multiple years of legal practice in the hospitality sector, specializes in contract negotiation, mergers and acquisitions, asset management, franchise and intellectual property in China, North America, and Africa.

See appendix for full biography.

UNDERSTANDING THE DIFFERENCE IN OPERATING MODELS

MANAGEMENT

Brand as the manager of the hotel

Management model is the most widely used model among international operators in China. As the positioning of the brands and service complexity goes up, this model starts being preferred by brands. The fundamental characteristic: the brand is also the hotel manager.

Choose the right operating model for your hotel.

FRANCHISE

Owner as the manager of the hotel

Franchise model is widely used in North America. Most international hotel operators have focused on developing their brands rather than the operational management of hotels. As a result, they are now using the franchise model, apart from their upscale and luxury brands, particularly in flagship locations, where they are reluctant to lose the control that direct management ensures. Franchise model usually works best in very standardized hotels/brands, where brands provide the SOPs and trainings to the owner/operator of the hotel.

THIRD PARTY OPERATOR

Professional hotel operator (not the brand) as the manager of the hotel

Third Party Operator (TPO) model is also widely used in North America where the Owner, the Operator and the Brand are separate parties, which is less common in China. This model becomes applicable when hotel owners face a scarcity of brands able to perform the operational management of their hotels with the degree of specificity and hands-on management that optimizing revenue and value creation require, while also being unable to perform those functions themselves. In this case the Owner hires professional operators to manage the hotel and license the brand from another party, which could be Marriott or IHG or Hilton, for example.

THE HISTORY OF FRANCHISE

UNITED STATES OF AMERICA

Where It All Began

Hotel franchising was born in 1907 when the Ritz Development Company in New York City granted a franchise to the Ritz-Carlton - this was the beginning of the franchise model widely spread across the world today. Following this, Choice Hotels International was established in 1940, and subsequently franchised more than 7,000 hotels in more than 40 countries and territories. After that, Kemmons Wilson, the founder of Holiday Inn (now part of InterContinental Hotel Group) further solidified the concept in 1951 and built 400 motels across the US with uniform standards, now known as Standard Operating Procedures (SOP) in the hotel industry. Wyndham followed suit in 1954 with the creation of the Howard Johnson brand.
1960 to 1980 was the golden age of hotel franchise development in the United States.

PEOPLE'S REPUBLIC OF CHINA

The Next Promising Land

There is no clear indication on the history of hotel franchise development in China. Since the establishment of Jinjiang Hotel Group in 1996, China's hotel industry has gradually moved towards franchise chains of economic hotels. Then in 2002 and 2005, two other major hotel groups, Home Inn and Huazhu, were also established and quickly expanded thanks to the franchise model.

The first international hotel group to start franchising in China was Wyndham Hotel Group, the first Ramada hotel established in Wuhan in 2006. From 2014, international hotel groups, such as Accor and InterContinental Group, gradually opened up franchise rights for some brands in China, some of them being master franchisees with local hotel companies such as Plateno Group. The golden age of the hotel franchise in China is yet to come.

1907	Ritz-Carlton
1940	Choice Hotels
1951	Kemmons Wilson Holiday Inn
1954	Wyndham
1996	Jinjiang Hotel
2002	Home Inn
2005	Huazhu Hotel Group
2006	Wyndham - Ramada
2014	Accor and Hilton
2016	Marriott and IHG
2018	Hyatt

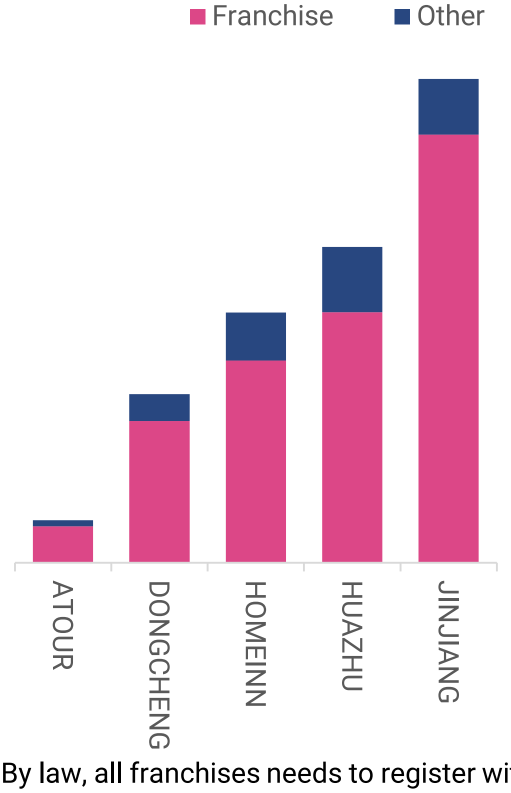
THE SUPPLY SIDE OF THINGS

WHO OFFERS FRANCHISE IN CHINA

The Domestic Players

Most domestic hotel companies started with budget hotel franchises and recently moved into the mid-end market. In regards to the franchise model, they are much stronger in market presence and rate of growth compared to the international hotel companies. The below graph illustrates the number of properties currently under operation by major domestic hotel companies.

Number of Hotels By Hotel Groups



By law, all franchises needs to register with the Ministry of Commerce 15 days after the signing of franchise agreement, thus we choose to relay on the registry information to analyze the brands franchised by the major hotel groups and numbers of registries.

The International Players

The management model is still the primary expansion method of international hotel companies. However, strategic alliances and partnerships with domestic players show that they are also setting their eyes on expansion through franchise, and many choose to partner with local businesses.

Group	Brands	Reg. Property
Wyndham	Wyndham Ramada Wyndham Garden Microtel Wingate	8
IHG	Holiday Inn Express Crowne Plaza Holiday Inn Holiday Inn Resort HUALUXE	80
Accor	Ibis Mercure Grand Mercure Novotel Pullman	358
Hilton	Hilton Doubletree by Hilton	2
Hyatt	Unbound Collection	2

Note: Marriott had no registry with Ministry of Commerce regarding franchise, thus not included in the table above.

FEES AND COSTS OF A HOTEL FRANCHISE

FEES TO BRAND

Royalty Fee

Franchisees usually have to pay a royalty fee to obtain the right to use the brand's trademark and other specific services. This kind of fee is also the main source of franchisor's income. The calculation is usually based on the percentage of room revenue, while some hotel brands also charge a separate fee from food and beverage revenue.

Reservation Fee

The brand generally provides franchisees with an independent booking channel, and the cost of maintaining such channel will be borne and shared among the franchisees. Usually, the reservation fee is calculated based on the percentage of revenue or/and by the successful bookings. Depending on different booking channels, the fee can vary. Some common ones are central reservation system (CRS), global distribution system (GDS), online travel agency (OTA) and brand official website.

Marketing Fee

For the purposes of refreshing the brand‘s influence and popularity and increasing operational performance, the franchisor usually establishes a specific advertising and marketing fund to promote and publicize all brands globally or in a certain region. The franchisee usually needs to bear a part of this cost.

Initial Fee

The initial fee is to be paid along with the franchise application. The calculation is usually based on the total room count or a minimum amount plus additional rooms. The initial fee is to be paid when a franchise contract is signed and takes effect.

Frequent Traveler Program Fee

Hotel groups usually have their own frequent traveler programs. The franchisor usually requires the franchisee to bear the expenses incurred by the traveler reward program. The calculation is normally based on a certain percentage of room and F&B revenues. Such expenses are rarely accurately quantified in the franchise disclosure documents (FDD).

Miscellaneous Fee

This fee mainly covers additional technical support from the franchisor, as well as related trainings. Among the assistance services provided by the franchisor, the franchisee can choose (based on the operating model) such options as equipment purchase, voluntary marketing activities, periodic trainings, etc. Because of its elastic nature, some of the miscellaneous fees are not disclosed in the franchise disclosure documents (FDD), and thus can not be accurately quantified.

FEES AND COSTS OF A HOTEL FRANCHISE

OTHER FEES

Online Travel Agents (OTA)

OTAs is a very important channel for hotel distributions. Commission rates charged by the OTAs can be confusing, and they are frequently adjusted. Individual properties pay for bookings generated from an OTA, and in some cases, OTAs can account for more than 50% of the hotel reservations. Some brands have strategic partnerships (the hotel group level) with OTAs which offer better rate to their properties. Some brands also charge another layer of booking fees on top of the commission to OTAs. When choosing a brand, the franchisee needs to carefully investigate and compare the OTA commission rates and the fee structure to understand what they are signing up for, and the best fit for their property.

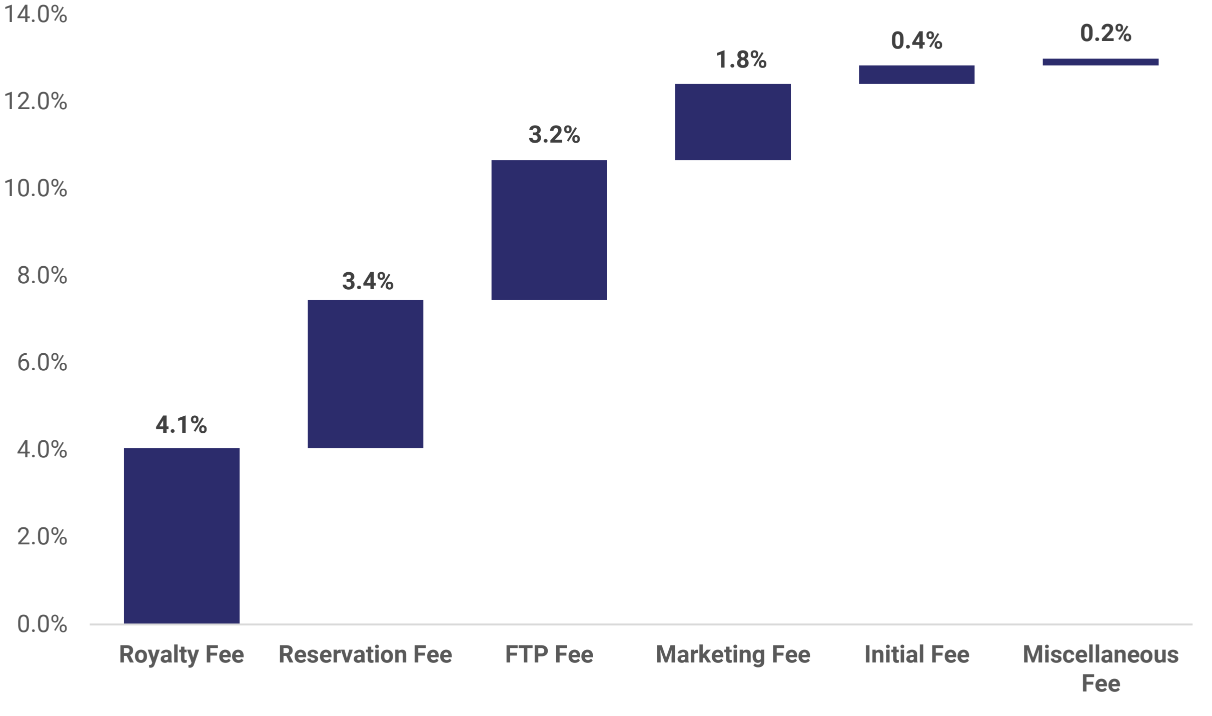
Property Improvement Plans (PIP)

Every brand has its own set of standards, and if the franchisee's hotel does not meet the standards, she will need to purchase and upgrade systems and facilities to meet them. Common standards are the room size, fitness facilities, number of F&B outlets, ceiling height, and MEP requirements. This cost is usually incurred with existing infrastructure and properties. Before the brand agrees to put its name on the door, the technical team will come and inspect the property, and provide a report called "Property Improvement Plan" to inform the franchisee what needs to be done in order to meet the brand standards. Some franchisors will charge a fee for facility inspection. At the end, the franchisee should have a clear picture on how much it would cost to upgrade her property.

OTAs can account for more than 50% of the hotel reservations.

FEES AND COSTS OF A HOTEL FRANCHISE

FRANCHISE FEE % FROM ROOM REVENUE BY THE TYPE OF FEES

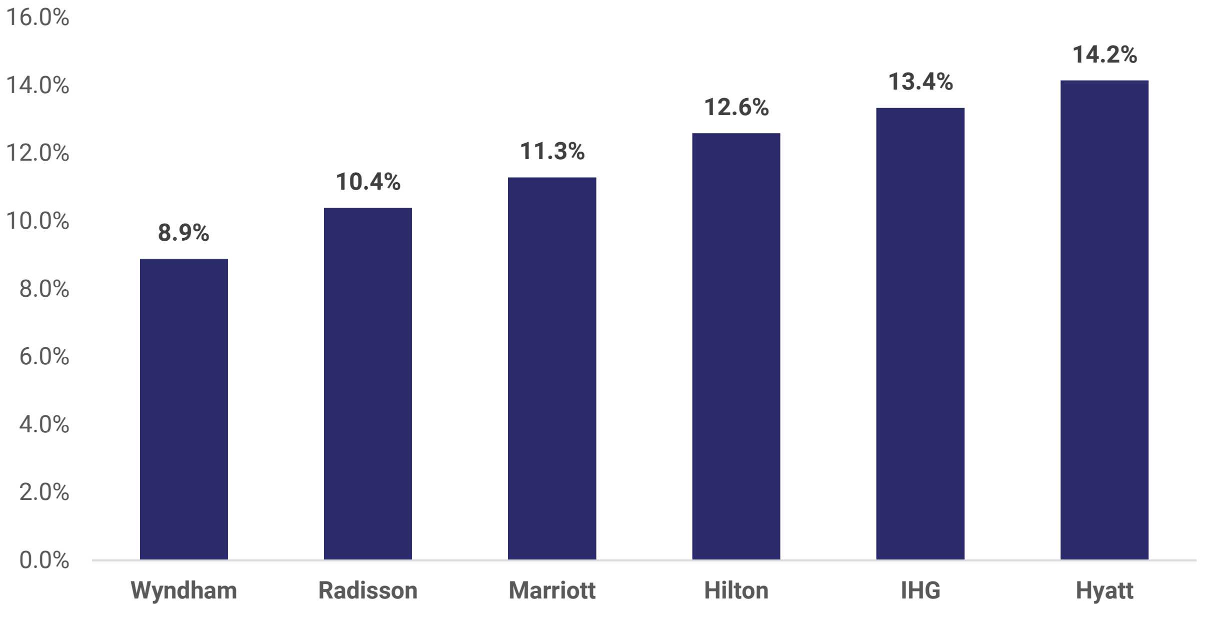


The above graph illustrates different categories of fees in terms of room revenue percentages. Due to the differences in the fee structures among brands, where some fees are percentage of room revenue while others are based on total revenue or fixed fee, we were forced to make some basic assumptions in the revenue composition, as well as applicable rates. The projected revenue is the average for a normal operating year.

A franchisee needs to pay an average of nearly 12.8% in the first ten years of the hotel operation. Royalty fee accounted for the largest part of the cost, reaching 4.1%, closely followed by the reservation expenses. Since the reservation fee here does not include the OTA fee in China, this cost is likely higher for franchisees. Although the initial fee is normally high, it usually only occurs in the first year, so its proportion is relatively small - only 0.4%. Frequent traveler program fees are hard to predict, but with the hotel groups that have a good FTP program, the percentage of member spending is likely to play a significant role.

FEES AND COSTS OF A HOTEL FRANCHISE

FRANCHISE FEE % FROM ROOM REVENUE BY THE HOTEL GROUP



The above graph illustrates the franchise fees to the associated brand in a relative scale. It is used as a reference to reflect the average fee we see in China market. However, due to the differences in the positioning of the brands under each group, the franchise fees will vary greatly, so franchisees need to apply the fee structure according to their unique situation. For example, the terms and fee offerings from the brand can be different based on cities, locations, property size, and other factors which changes the negotiation power of the franchisees.

Brands usually have different fee strategies, some have lower entry barriers but higher continuous fees, while others operate in the opposite manner. For example, Wyndham Group's initial fee is relatively low but royalty fees are higher; IHG does not charge a royalty fee on revenue other than rooms, which makes it comparably high; Hyatt, Hilton and Marriott Group charge a royalty fee on F&B and/or other non-room revenues; IHG's marketing fee is relatively lower than other groups. Note that the types of fees mentioned earlier in our report are not generic but are of a similar nature, and for the ease of calculation, we have grouped them together and generally categorized into six fee types.

SWOT OF THE FRANCHISE MODEL

STRENGTHS

Start-up Assistance

The model gives the franchisee the opportunity to carry out business activities in an unfamiliar industry/field; since the franchisor already has rich and established experience and expertise in the area, the franchisees are offered the support and guidance from the franchisors. Common assistance includes site selection, marketing and distribution, financial modeling and budgeting. Entrepreneurs will be able to start off easily.

Established System

The franchise model relies heavily on corresponding platforms and systems, especially hotels. The franchisors normally have effective systems in place with little or no lead time for implementation and execution, as well as support and maintenance in place in case of need.

Less Capital Involvement

Undoubtedly, the initial fee is not a small expense for entrepreneurs, but the cost of starting a business independently is also very high, and it is considered less risky to operate under a proven model. The development of a company design, operation, planning, etc. can be very costly.

Product Innovation

To maintain competitive advantages over other opponents, franchisors usually have more professional product teams to develop and update product content to maintain the development of the whole brand chain; it is more effective than entrepreneurs developing these by themselves.

OPPORTUNITIES

All About Efficiency

From the brand's perspective, the franchising model is the most efficient way to speedily expand its market presence. From the franchisee's point of view, it offers fast and easy path to setting up a potentially profitable business with a proven track record, as well as an established network of support and customers.

Flexibility

Franchise model usually gives more flexibility in the daily management. Even though the brand has certain guidelines, since daily management still depends heavily on the franchisee, there is more room for innovation and hiring people of the franchisee's preference to do the job.

SWOT OF THE FRANCHISE MODEL

WEAKNESSES

A Great Variety of Costs

Franchise model usually requires upfront payment, and it continues after the property entered operation. Common fees include marketing fee, royalty fee, etc. Furthermore, franchisor usually has a set of suppliers, and sometimes price can be higher than market rate. In this case, the franchisee will need to bear the costs due to the enforcement of brand standards.

Limited Freedom

The opposite side of the multi-faceted support is the limited operating freedom. In order to maintain the uniform quality standards, the franchisor will set up a series of rules to ensure that the franchisee performs in accordance with this standard, thereby maintaining the brand image. However, for those entrepreneurs who seek freedom to play, it will greatly limit their freedom of decision-making.

Reluctant to Change

Being a part of a big franchise sometimes means low adaptability towards market change. Franchisors usually implement a span of controls for consistency across all properties, thus individual businesses can be less flexible and slower in reacting to local market demand. The entrepreneur can’t launch something new or update any of the existing products/services to adapt to its own market.

THREATS

Outdated Brand and Product

Brands sometimes have outdated products and services as they grow. There will be many competitors in the same field, and if the brand does not have a more relevant growth strategy, it will eventually lose its competitiveness, market share and in the worst-case scenario, close its doors completely. Franchisee, in this case, will stand on the wrong side of the history with no power to change anything other than giving up the business.

Reputation Uncertainty

Undoubtedly the most important asset of the franchisor is its brand. When brand value deteriorates, franchisees will also face uncertainties for the brand’s volatile reputation and potential negative effects on business. Because of the chain nature of the business, the reputation of any one of its properties might affect the reputation of other franchisees under the brand. In the case of OYO, the brand’s reputation became unreliable, untrustworthy, and low quality. Such image is projected to its properties and thus hurts the individual owners. Therefore, the franchisee's in-depth understanding of the franchisor's attitude towards brand reputation maintenance will be particularly essential.

CASE STUDIES

INTERCONTINENTAL HOTEL GROUP

Holiday Inn Express takes the lead

As of the end of the second quarter of 2020, 20% of InterContinental hotels are franchised, 45% of hotels under construction are going to become franchised operations. The proportion of franchise hotels in China is growing.

InterContinental Hotel Group offers the following franchise models:
Type 1: Traditional all-franchise model;
Type 2: Certified third-party operator manages the daily operation where IHG licenses the brand; and
Type 3: management franchise, appointing general manager of the hotel to ensure the implementation of brand standards.

The major franchised brand from IHG is Holiday Inn Express (overall 40% are franchised). The newly opened Holiday Inn Express hotels are 90% franchised. From 2017, InterContinental Hotel Group has further expanded its franchise operations to Crowne Plaza and Holiday Inn Hotels in China. InterContinental Hotel Group is the most successful international hotel brand self-developing the franchise model and has already become relatively successful in penetrating the Chinese market. Thanks to its first mover advantage, good and steady expansion, Holiday Inn remain the most recognized foreign hotel brand in China.

OYO

The epic failure

OYO was founded in India in 2013 and started expanding into China since 2017, with 600 million USD and Softbank in its pocket, OYO was the hottest and most promising company to erupt the traditional hotel industry at the time.

OYO is not a typical franchisor, it is considered a cooperative partnership that relies on the brand's reservation channels. However, it has the important characteristics of a franchise, which sells the brand and distribution channels to benefit individual hotels by putting its name on the door. Due to a low threshold of joining the OYO franchise, which charges no franchise fees, the company expanded rapidly in China. In the first year of its operation, the company opened 5,656 properties, 270,000 rooms.

However, OYO is weak in quality control and maintaining standards (a very different model compared to Holiday Inn), thus offers no consistency to their guests; they were banned by major OTAs in China due to conflicting financial interests, which resulted in the lack of reservation channels; the company itself is having huge operation deficit, and with lack of support for its properties, the China operation was under fire and considered an epic failure in the phase of expansion.

THE LEGAL ENVIRONMENT

CHARACTERISTICS OF THE CHINESE FRANCHISE LAW

1. The Intellectual Property Nature

One of the characteristics of China's hotel franchise legal environment is that it classifies franchise contract disputes as intellectual property disputes, which are heard by the intellectual property court, rather than by the civil courts like other hotel management disputes (excluding arbitration proceedings). Judges of the intellectual property court may employ a different set of rules in interpretation of facts, dispute merits and trial proceedings compared to those of the civil court.

2. Fact vs. Form

Another characteristic of China's hotel franchise law is that it emphasizes facts instead of the form. The franchising model in China is still in its early development, which is why there are many franchise forms in the market. With less standardized market practice, therefore, Chinese law clearly stipulates that terms of agreement and the nature of the operation model determines whether it falls under the franchise law. It also emphasizes that when the contract terms are inconsistent with the actual business model, the actual business model prevails.

3. Legal Provision vs. Legal Validity

China's hotel franchising regulations tend to focus on the terms of legal provision rather than the validity of the contract. In short, the consequences of violation are mainly penalties, rather than effect on the validity of the contract. In other words, the franchisee can not claim the contract is invalid because franchisor did not meet the requirements of opening two stores within a year or violated the filing process.

The franchisee may unilaterally terminate the contract without any penalty within the cooling period.

4. The Cooling Period

Similar to international practices, Chinese franchise law also protects the franchisees by giving them the right to solely terminate. The law requires the grace period to be clearly stipulated in the franchise agreement; “Cooling Period” means the franchisee may unilaterally terminate the contract without any penalty within the period.

DISPUTES AND ARBITRATIONS

International brands and regional large-scale franchisors mainly use arbitration as the method of dispute resolution, while smaller players are likely to choose court litigation instead.

1,300

Cases related to franchising disputes are on the rise. In 2019 alone, there were more than 1,300 court cases across the country.

80%

Among the cases involving hotel franchising, cases involving franchisees (plaintiff) v. franchisors (defendant) account for a large proportion, exceeding 80%. The reasons for the dispute are mainly on the nature of the franchise, the franchisor's operating qualifications on filing and whether the franchisor meets the requirements of "two stores per year“ policy.

Common dispute matters include such issues as whether the franchisor appropriately disclosed required information to the franchisee; the termination within the grace period; and the support, services and/or products provided by the franchisor not meeting the expectations.

In the process of handling these dispute cases, it is clear that the franchisees have insufficient knowledge of the franchise agreement, there is a significant gap in understanding and a lack of grasp of the law provision, near absence of comprehensive understanding of their own rights, and insufficient risk management ability.

THE COMMON MISTAKES

FRANCHISOR/BRAND

Brand Asset to Protect

From the perspective of the franchisor, the specific market can be quite foreign to their knowledge, thus mistakes might be made when evaluating the market potential and financial forecast.

No matter what, franchised hotels rely on the owner and operator to run the daily business, thus the result might be different from the brand standards. A poorly run property can ruin the brand's equity, and with a diversified owner's pool, it is more difficult than ever to maintain the same quality. This is also why hotels are relatively cautious in giving out their higher-end brands. An owner with hotel experiences or/and certified third-party operator may reduce the risk of brand dilution.

FRANICHISEE/OWNER

Wrong Market and Wrong Approach

From the perspective of the franchisee, franchising a strong hotel brand can certainly benefit the hotel. But even the best hotel brand needs the right market. First question to ask before finding the brand is whether the market is ready to accept what the brand has to offer.

Secondly, franchisees often have different expectations in regards to the support from the brands. A common mistake is that the franchisee relies too much on the support and opinions of the franchisor and does not seek truth from facts to adjust her strategies accordingly. The success of the business still depends on daily management, and it shouldn't be forgotten just because there is a brand on the door.

FREQUENTLY ASKED QUESTIONS

Q: WHAT CAN I DO WHEN I FEEL THE FRANCHISOR HAS FAILED TO PROVIDE VALUE AND SUPPORT?

This question reflects the most common criticism towards franchisors and is raised frequently by franchisees.

Legally, the handling of this issue largely depends on the franchise agreement signed by both parties (including attachments, side notes, franchise manuals, disclosed documents, etc. that may be regarded as part of the contract). If the franchisor fails to perform the promised system support, technical support, service standards, product delivery and other obligations agreed upon or guaranteed in the contract, it may be deemed a breach, and the franchisee has the right to request compensation, reduction or exemption of fees, and/or termination of the contractual relationship without penalties.

It is important to note that the advertisements or brochures used by the franchisor in the process of promoting the franchise business are usually not considered the content of the contract, thus such materials are not viewed as obligations made by the franchisors, so in case a dispute occurs on the content of the advertisements, it is hard to be recognized and enforced in the franchisee's favor.

Q: WHAT HAPPENS WHEN THE FRANCHISOR CHANGES ITS STRATEGY?

In 2016, an internationally renowned hotel group formed a strategic alliance with a domestic hotel group. According to the arrangement, the domestic hotel group becomes the exclusive franchisee (or master franchisee) of one of its brands (lets call it Brand X) in China, responsible for the expansion, development and operation of the Brand X.

Based on this change in strategy, the international hotel group issued a notice to all its existing franchised hotels of Brand X, requesting the owners to change the signing entity of the franchise agreement to the domestic hotel group, and switching the system support. This arrangement caused class action from a number of owners who believed their rights were violated and initiated arbitration action against the international hotel group.

This is a classic case of misalignment of expectations, the franchisees (existing) saw the strategic action as breaking the promise of what they have signed up for. On the other hand, the hotel groups are just finding ways to expand their businesses, but, unfortunately, at the expense of some owners.

Legal opinion in the article is provided by Gary Zheng, Partner at Dentons, specialist in the hotel management contract negotiation. Find Gary's full biography in the appendix.

THE NEXT GENERATION OF HOTEL FRANCHISE IN CHINA

DIVERSED BRAND OFFERINGS

Higher-end and Diversified

For now, the international hotel groups' "franchisable" brands in China are still mainly budget or limited-service hotel brands. In this sector, the international chains are rather outnumbered by domestic players. However, in the higher-end hotel market, we still see international players being dominant in terms of brand recognition. As more owners become experienced in hotel operation, the chains will be more willing to release their high-end brands to selected projects. The first wave of high-end brands will probably start with the five stars and lifestyle/soft properties.

BRAND AND CHAIN

The Efficient Way to Grow

In the US, chain hotels account for 70% of all hotels, and more than 90% of these hotels are franchised. This number in China is only 26%. China offers huge market potential for brands to expand in. On the one hand, the management model is no longer viable for the big chains, and franchise is the only way to quickly expand and penetrate the market without the toll of management capacities. On the other hand, as the chain continues to grow, either through acquisition of smaller brands or affiliation, the market power of chain becomes more dominant. Independent hotels will likely go under the umbrella of the chain to have better distribution and support.

SPECIALIZED THIRD PARTY MANAGERS

Expertise in Operation

Third party management (TPM) is commonly used in more developed hotel markets like the US and Europe, but is less recognized in China. Based on the history of the franchise development in other markets, TPM is a key factor in whether franchising can develop rapidly.

As China catches up in the hospitality industry worldwide, we see that it follows a similar pattern but with faster pace and more innovation than ever, while learning along the way. There will be room for growth for the operations-focused companies to take over daily management from either the hotel management companies or the owners.

Third party management usually means shorter and more flexible management terms, higher operational efficiency compared to self-management; such companies normally have fewer hotels in their portfolio compared to the big chain operators, resulting into more focus and support for the individual properties.

HOTEL FRANCHISE IN AFRICA

OUR THOUGHTS ON AFRICA

Just the Beginning

Other than China, another region of interest is Africa. Africa has been receiving a fair amount of attention from local and international developers recently. Its hospitality industry swiftly became a beneficiary of sizable amounts of investment, which allowed it to grow from a bit under 30,000 rooms in 2009 to almost 80,000 eleven years later. Such trend would not have been possible without the ambitious expansion plans from some of the biggest hotel chains in the world – Accor, Marriott and Hilton among them – and their subsequent contribution to the continents' hospitality scene. Despite the rapid development though, the overall market remains quite fragmented. Most hotels are still independently owned, and none of the big chains could claim an unquestionable dominance in either resort or business destinations.

So, what does this mean for other hotel operation models, such as franchising? While it is relatively well-established in North America and Europe and is gaining speed in Asia, it seems Africa's time is yet to come. Sunmei Group, a Chinese company focusing primarily on the emerging markets, is perhaps one of the few players attempting to introduce and successfully implement mid- to upscale hotel franchising across the continent. Last year they announced the entrance of their three brands - Ivy Hotel, Rizti and OAK – and are set to open the first property in Ethiopia.

Apart from Sunmei, IHG has also ventured into the franchise model on the continent. In 2019 the group has signed a Master Development Agreement (MDA) with Valor Hospitality Partners Africa to roll out multiple franchise hotels in the next 10 years. The first hotel to benefit from this MDA is VOCO The Bank, Rosebank in South Africa – the new upscale brand's landmark property in the region.

Despite these examples, few others seem to rush into the region with the franchise model. One reason could be the potentially higher monitoring costs and difficulties in adhering to the parent company's standards, which could drive the franchise fee up to the point, where it would be more profitable for the owner to opt for the management contract. Secondly, the majority of international brands are still looking to develop upper-upscale and luxury markets in Africa, while franchising is more common among budget and midscale brands.

However, given the rapid development of domestic travel (especially during the post-covid times), the rising local disposable incomes and the ever-improving intra-continental infrastructure and connectivity, both the global and local players should pay more attention to the midscale business lodging sector, which could just become a very suitable candidate for a successful franchise development in Africa.

FRANCHISE DUE DILIGENCE TOOL KIT

REGULATIONS ON THE ADMINISTRATION OF COMMERCIAL FRANCHISING

With the development of franchising in China, the legal provisions for franchising are gradually improving. Here is a checklist to help you start!

☐ **ADMIN**
The franchisor's name, domicile, legal representative, registered capital, business scope, and basic information about the franchise activities;

☐ **TRADEMARK**
The franchisor's registered trademark, corporate logo, patent, know-how and business model basic information;

☐ **FEES**
Types, amounts and payment methods of franchise fees (including whether to collect a deposit and the conditions and methods of the return of the deposit);

☐ **COSTS**
The prices and conditions of the products, services and equipment provided to the franchisee;

☐ **SUPPORT**
Continuously provide specific contents, methods and implementation plans of business guidance, technical support, business training and other services for franchisees;

☐ **BUDGET**
Franchising investment budgets of operating outlets;

☐ **NETWORK**
The number, geographical distribution, and evaluation of operating conditions of the existing franchisees in China;

☐ **FINANCIAL**
A summary of the financial accounting and audit reports undertaken by an accounting firm in the last 2 years;

☐ **LEGAL**
The litigation and arbitration related to franchising in the last 5 years; Whether the franchisor and its legal representative have any major illegal business records;

☐ **OTHERS**
Other information required by the competent commercial department of the State Council.

Check this information before signing the franchise contract.

APPENDIX

BIOGRAPHY OF GARY ZHENG, PARTNER AT DENTONS

Beijing Dacheng Law Offices, LLP (Dentons)

Position:	Partner/Attorney Leader of Dentons Global Hotel and Leisure Industry Group Director and Deputy Secretary-General of Dentons China Technology, Entertainment and Leisure Committee
Telephone:	+86 10 5813 7799
Mobile:	+86 139 1057 1602
Email:	zhigang.zheng@dentons.cn

In the field of international hotel management, Gary has many years of accumulated industry background and professional legal service experience. He is familiar with the background, rates and service conditions of international and domestic hotel management groups. He has worked in dozens of domestic and overseas hotel projects in China, the United States and Africa. Gary represented hotel owners and developers in HMA negotiation and termination against Marriott, Hilton, InterContinental, Four Seasons, Starwood (acquired by Marriot), Accor, Fairmont (acquired by Accor), Hyatt, Ascott, Club Med, Pragma, Cavalli, Carlson, MGM, Hard Rock, Howard Johnson, Argyle, Mövenpick, BTG Nikko, Kaiyuan and other international and domestic hotel groups negotiate hotel management projects.

SUPPORTING DOCUMENTS

1. Regulations on the Administration of Commercial Franchising (2007)
2. Administrative Measures for the Recordation of Commercial Franchising (2011)
3. Administrative Measures for the Disclosure of Commercial Franchise Information (2012)
4. Guiding Opinions of Beijing Higher People's Court on Several Issues concerning the Application of Law in Trial of Commercial Franchise Contract Disputes (2011)
5. Q&A from Shanghai Higher People's Court on several issues concerning the trial of disputes over franchise contracts (2012)

Karen Liu

Head of Project Development Service
Karen.liu@aahmco.com