

# Factors contributing to middle market hotel franchising in Korea: the franchisee perspective

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## Abstract

It is likely that the franchising of mid-class hotels will achieve success in Korea as in North America and some other parts of the world. This study examined franchisee perspectives in Korea. Using factor analysis technique, this study identified seven factors that were likely to influence franchise purchases: local environment, brand name, partner characteristics, support services, system quality, cost and communications. Multiple regression analysis was then applied to examine the relative importance of each of these factors in determining franchise purchase intention. In order of importance, partner characteristics, support services and cost were found to be the three most significant factors in determining purchase intentions. The study suggests that the franchising of mid-class hotels can be successful in South Korea, but some changes to traditional franchise methods may be needed.

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## 1. Introduction

The importance of franchising to the development of the lodging industry cannot be overstated. Franchising was the vehicle for the initial expansion of the motel segment in the 1950s in the United States (Brown & Dev, 1997). Franchising, which had seldom been used until the 1980s, has since been implemented in many European small and medium sized hotels (Connell, 1997). International franchising can play an important role in the Korean “middle market” hotel segment since franchising offers a less risky way to get into the hotel business, provides advantages such as world wide recognition of hotels by foreign travelers and standard services and products better than those found in many independent hotels.

Tourist hotels consist of luxury A, luxury B, first, second and third class standards in terms of level of services in Korea. The middle market consisting of first class hotels represents 30% of total room supply in Korea. In general, middle market hotels have excellent locations. Middle market hotels are cheaper than luxury

hotels but provide limited services. For example, the operation is more focused on rooms rather than food and beverages when compared to luxury hotels. A typical hotel in the middle market has 100 rooms and one or two restaurants while a typical luxury hotel has 400 rooms, five or six restaurants and other facilities. According to The Korea Tourist Hotel Association (2002), the ratio of room to food and beverage sales is 52–48% among middle market hotels. This is quite different from luxury hotels whose sales ratio of room to food and beverage is 40–60%.

There is a high potential for profit for middle market hotels due to location, price and a good match between service and product attributes for the price sensitive traveler demand. However, a low recognition of hotels by foreign travelers and a lack of standard services and products impede the maximization of the segment’s profitability. In fact, few foreign travelers stay at middle market hotels, which are domestic and independent. Therefore, it is essential to promote middle market hotels more aggressively through internationalization to attract foreign travelers in Korea (Cho, 1999).

The purpose of this study is two-fold. The first is to identify the underlying dimensions or factors considered when Korean independent middle market hotels

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purchase franchisee rights. The second is to examine the relative importance of the derived factors in relation to franchise purchase intention. Hotel franchise companies, especially international companies, who want to buy or sell hotel franchises are faced with a problem of which factors will contribute to a successful franchising agreement. The problem is that there is no comprehensive source of information on this aspect of the Korean hotel industry. Therefore, systematic analyses of franchise purchases are quite timely and useful to both franchisors and franchisees. It is hoped that this study will help hotel franchise companies and prospective Korean hotel franchisees because both have a mutual interest in matching each other's needs and operating a successful business.

## 2. Franchising and the middle market

The origins of modern-day hotel franchising can be traced back to the 1950s when Holiday Inn established itself as the economy segment's primary business format franchisor (Shook & Shook, 1993). Hotel companies that applied stricter operating standards than had previously been common among independent hotels have subsequently expanded and grown in the economy segment by means of franchising (Lee, 1985).

At the heart of the operation of an international hotel is the management contract or franchise agreement. Franchising is more popular in the economy (small size) or middle (medium size) market while management

contracts are more popular in the luxury (large size) market. As shown in Table 1, the leading middle market hotel companies used franchising much more than management contracts as their expansion strategy. Dev, Erramilli, and Agarwal (2002, p. 101) found that "generally speaking, when quality competence is an important source of competitive advantage, the tendency to choose a management contract becomes stronger as the hotel increases in size. However, when quality is not an important source of competitiveness advantage, management contracts are less preferred and the use of franchising become more likely as the hotel size increases."

Smith Travel Research (1999) in the United States classifies chain hotels as upper upscale, upscale, midscale with food and beverage, midscale without food and beverage, and economy. Table 2 shows that the highest level of room demand growth occurred in the middle segment over the past few years: each day hotels in this segment sell over 120,000,000 rooms a day, a 20% increase from 1993 to 1999. It is interesting to note that limited service operations such as midscale, without

Table 2  
Rooms sold per day in the US

Segment	1993	1999	Growth
Luxury	447,093	549,965	102,872
Middle	556,409	677,201	120,792
Economy	331,750	420,308	88,558

Source: Smith Travel Research (1999).

Table 1  
Major middle market hotels and their expansion methods

Company	Brand	Hotels	Rooms	Owned	Managed	Franchised
Cendant Corporation	Howard Johnson Franchise Systems	526	55,432	0	0	526
	Ramada Franchise Systems	977	128,416	0	0	977
Choice Hotels International	Comfort Inn	1568	123,896	0	0	1568
	Clarion	116	18,504	0	0	116
	Quality Inn	622	71,615	0	0	622
	Sleep Inn	149	11,073	0	0	149
Six Continents Hotels	Holiday Inn	1560	294,659	22	55	1483
	Holiday Inn Express	713	57,753	0	0	713
Marriott International	Courtyard	382	53,100	0	232	150
	Residence Inn	277	33,000	2	115	160
	Ramada International	50	8,600	0	11	39
The Hilton Family	Club Hotels by Doubletree	16	3291	0	7	7
	Hampton Inn	775	82,329	11	7	757
	Hampton Inn and Suite	42	4799	0	3	39
	Red Lion	17	2616	7	4	0
Starwood Hotels and Resorts	Four Point Hotels	82	14,883	0	76	2
	Sheraton Inn	22	7746	0	0	22

Source: Adapted from Lutz (1999) and Michael (2000).

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