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ScienceDirect
International Journal of Hospitality Management 27 (2008) 368–380
INTERNATIONAL JOURNAL OF Hospitality Management
www.elsevier.com/locate/ijhosman

International franchising: Opportunities for China's state-owned hotels?

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Abstract

The hotel industry in China faces global competition. Most of the state-owned hotels have struggled during the period of transition from a planned economy to a market economy. Furthermore, international franchising hotel chains have entered China with their different operation modes. Could the franchising hotels bring opportunities for state-owned hotels? In an attempt to answer this question, the researchers carried out a study of state-owned independent hotels and state-owned franchised hotels to analyze their external and internal business factors, their intentions to join international franchise operations and the international hotel franchisors in China. The research technique used was qualitative. Two rounds of in-depth interviews were conducted. Content analysis was used in the data analysis. Results indicate that the majority of state-owned independent hotels have intentions to join an international franchise operation in the next 5 years. It also identified major factors affecting the franchising of state-owned hotels in China. However, franchising may not be attractive to those hotels that want to keep their management culture and characteristics. Implications of the study were discussed. Recommendations were provided to the state-owned hotels. Future research studies have been suggested to examine the relationships between franchisors and franchisees.

Keywords: Hotel franchising; China; State-owned hotel properties; Hotel expansion strategies

1. Introduction

During the transitional period from a planned economy to a market economy, the state-owned hotels in China faced keen competition, mainly from international hotel chains (Pine, 2002). With rapid economic growth, political and social stability, and the abundant supply of human and natural resources, China has attracted multinational hotels including the world's top hotel chains to this potentially huge market. According to the United Nations, World Tourism Organization (UNWTO), it was forecasted that by 2020, China would be the world's number one tourist destination with annual arrivals of 130 million (WTO, 2000). By 2002, the 'star-rated' hotels had reached 8880 (Table 1). On the Mainland, foreign and privately owned hotels cropped up, including Hong Kong-, Macau-, and Taiwan-owned hotels, and hotels of other ownership forms. However, state-owned hotels still occupied the largest proportion of the market (Table 2). State-owned hotels are hotel properties owned and managed by various government statuary bodies.

Different hotel alliances were formed through direct investment, management contract, merger/acquisition, franchising and consortia in order to make rapid expansion. China's state-owned hotels faced challenges and opportunities in the globally competitive environment.

Most state-owned hotels are looking for ways to expand and deal with the increasing competition. One way to survive is to join an international franchise operation. Franchising, which is the focus of this study, is defined by the International Franchise Association as a "continuous relationship in which the franchisor provides a licensed privilege to do business, plus assistance in organizing, training, merchandising, and management in return for a consideration from the franchisee" (Khan, 2005). The research questions for this study were: (1) What were the state-owned hotel general managers' views on the external

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doi:10.1016/j.ijhm.2007.10.002

Table 1
China's star-rated hotels in 2002

Star-rating	Hotels	Rooms (thousands)	%
5	175	64.9	7.23
4	635	143.5	15.99
3	2846	246.5	38.63
2	4414	306	34.1
1	810	36.4	4.06
Total	8880	797.3	100

Source: China's News Web (2003).

Table 2
Star-rated hotel ownership statistics in 2002

	No.	%
State-owned	5061	56.99
Collective	893	10.06
Foreign investment	279	3.14
HK, Macau and Taiwan investment	407	4.58
Private and other forms	2240	25.23
Total	8880	100

Source: China National Tourism Administration (2003) and China's Star-rated Hotels Statistics Bulletin.

business environment affecting the management of state-owned hotel properties? (2) What were the state-owned hotel general managers' views on the internal business environment affecting the management of state-owned hotel properties? (3) What were the state-owned hotel general managers' views on their intentions of joining an international hotel franchise? (4) What could the international hotel franchisors do for state-owned hotels in China?

State-owned hotels face both threats and opportunities in a changing economic structure and business globalization. Whether state-owned hotels with poor performance can solve operational difficulties would decide their survival or death (Yi, 2003). The purpose of the study was to investigate the possibilities of state-owned hotels in China joining international hotel franchising. The views of the General Managers (GM) from the state-owned independent and state-owned franchised hotels were compared using external and internal business factors, and the international hotel franchising advantages and disadvantages in China. The findings shed some light on whether international hotel franchising could bring opportunities to state-owned hotels.

The organization of the paper is as follows: first, an overview of the hotel industry trends in China was provided; second, literature on hotel expansion strategies and managing change was reviewed; third, the methodology of the study was explained; fourth, findings were presented; and finally, the implications of the study were discussed and conclusions were drawn.

2. Review of literature

2.1. Franchising and business growth strategy

Franchising can be described as a business relationship whereby a franchisor permits a franchisee to use its brand name, product, or system of business in a specified and on-going manner in return for a fee (Felstead, 1993). Strong partnerships require sacrifices on the part of both the hotel and its franchisor headquarters (Brown and Dec, 1997).

Franchising has been used as a method of business expansion in many parts of the world (e.g., the United States, Canada, the United Kingdom, Western Europe, and the Asia-Pacific Rim). For companies with an established network of wholly owned outlets, the cost of extending distribution systems becomes marginal, making franchising a potentially more cost effective method of business expansion than acquisition or organic growth (Sanghavi, 2004). Alon and McKee (1999) developed "a macro environmental model" of international franchising. According to the model, there are four factors important to a country analysis including: (1) economic, (2) demographic, (3) distance, and (4) political dimensions. In terms of the economic dimension, "Gross Domestic Product (GDP) growth", "GDP per capita" and "level of urbanization" are key variables. The demographic dimension includes the "Extent of the middle class", "Population growth" and "Proportion of female labor participation". There are two main variables in the distance dimension: physical distance and cultural distance. The political dimension includes the analysis of "Internal political risk" and "External political risk". Two more dimensions were added by Anttonen et al. (2005). They were the (5) culture and (6) legislation. Culture variables (individualism/collectivism, power distance, uncertainty avoidance, and masculine/feminine) affect the feasibility and acceptance of a franchise system. Legislation, such as the treatment of competition, intellectual property, commercial contract, and taxation has a role to play in franchising decisions. The advantages and risks of global franchising to the franchisor are summarized by Stanworth et al. (2001) as follows: advantages include fewer financial resources required; raw materials can be produced internally; less susceptibility to political, economic and cultural risks; and franchisees are more familiar with local laws, language, culture, business norms and practices. Risks include possible difficulties in repatriating royalties; protecting copyright and intellectual property; policing quality standards; understanding laws, regulations, language and business norms; and servicing franchisees, terminating contracts and local limitations.

A previous study has identified three primary motivations for franchising (Dant, 1995). First, franchising is an efficient way to collect the three fundamental resources a growth-oriented company needs: financial capital, market knowledge and human capital. Second, franchising is a vehicle to achieve a variety of scale economies. Third, franchising is perceived by agencies as an effective answer