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Hotel Brand Conversions: What Works and What Doesn't

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Abstract
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EXECUTIVE SUMMARY

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ABOUT THE AUTHOR

Chekitan S. Dev, Ph.D., is associate professor of strategic marketing and brand management at the School of Hotel Administration. Recognized as a leading authority on strategic marketing and brand management, His award-winning research has been published in several peer reviewed journals, including the *Journal of Marketing* and *Harvard Business Review*. He has won all major hospitality research awards including the 2002 John Wiley & Sons award for lifetime contribution to hospitality and tourism research. Additionally, he has received several teaching excellence awards. A former corporate executive with Oberoi Hotels & Resorts, he has served corporate, government, education, advisory and private equity clients in over 35 countries on five continents as consultant, seminar leader and expert witness. These include Accor, Atlantis Paradise Island Bahamas, Breeden Capital Partners, Chandris Greece, Crystal Cruise Lines, Disney, Expedia, ExpoGourmand Chile, eHow Technologies China, Four Seasons Mumbai, French Culinary Institute, Grupo Posadas Mexico, Hilton, Holiday Inn, Horwath Austria, HOTUSA Spain, Hyatt, IHRAI Philippines, InterContinental, Jampro Jamaica, Jumeirah Dubai, Kerzner Mauritius, Leela India, Mandarin Singapore, Marriott, Moevenpick Switzerland, National University of Singapore, NHV Japan, One&Only UK, Orbitz, Peninsula, PlanHotels Italy, Priceline, Rosewood, Sarovar India, Starwood, Taj India, Travelocity, Westin, YUM Malaysia, Zatisi Czech Republic and many others. Dev was selected as one of the “Top 25 Most Extraordinary Minds in Sales and Marketing” for 2009 by The Hospitality Sales and Marketing Association International (HSMAI). He has been interviewed on hospitality and travel trends by *TIME, Newsweek, The Wall Street Journal, The New York Times, The Washington Post, The Los Angeles Times, The International Herald Tribune, NBC Nightly News* and *National Public Radio*.

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Hotel Brand Conversions:

What Works and What Doesn't

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In March 2012 the Laurus Corporation, a private real estate development firm, purchased a 130-room Ramada Suites Hotel property near the Louis Armstrong International Airport in New Orleans (MSY). By April 2013 Laurus had remodeled the property to the tune of $2.7 million and converted it into a Holiday Inn Express & Suites hotel.[1] Such conversions are ubiquitous in the lodging industry. Anyone who regularly passes by an airport, for example, has likely seen adjacent hotel properties converted, perhaps multiple times.

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[1] Eliza Theiss, "Ramada Suites Hotel Completes Renovation, Converts as Holiday Inn Express," MHN Online, www.multihousingnews.com/cities/new-orleans/ramada-suites-hotel-completes-renovation-converts-as-holiday-inn-express/1004078105.html. Viewed July 9, 2014.

Hotel brand conversions, also known as reflagging or rebranding, constitute a widespread lodging industry tactic. By one estimate, one in three hotels have converted since they opened for business. Despite this frequent practice, few research studies have been conducted on the performance effects of hotel brand conversion. This lack of attention may be due to the complexity of the relationship between franchisors and franchisees or the lack of publicly available data where relevant factors are visible to researchers.

To address this information gap, two colleagues and I recently conducted a study that calculated the performance effects of conversions occurring in 1996 through 2010 by analyzing a sample of U.S. hotels tracked annually by PKF Hospitality Research using data for the years 1994 through 2012 (before and after conversions). In this study, conversions generated, on average, a 6.3-percent increase in occupancy rates for converted hotels. Other performance measures—total revenue, average daily rate (ADR), revenue per available room (RevPAR), and gross profit per available room (GOPPAR)—were also positive. My co-authors and I analyzed both conversion from one brand family to another (e.g., Starwood to IHG), and those for hotels changing flags under the same brand umbrella (e.g., Hilton to DoubleTree). We also considered the effects of conversion on competing properties. Our results provide useful data for hotel owners, hotel operators, brand managers, real estate developers, consultants, and financiers.

The wave of hotel conversions seems to make strategic sense, given the competitive nature of the hotel industry. STR lists 981 hotel brands in its chain scale database.[2] As these numerous brands vie for market share, they seek appropriate properties to represent them in key markets.[3] Brand conversions are part of the brands' expansion strategies. As just one example of this approach, an October 2015 article in the *Wall Street Journal* reported that 96 percent of the 4,406 new DoubleTree rooms added in the previous 12 months came from hotels converted from other brands.[4]

Conversions occur for any number of reasons, including a change in corporate strategy or local ownership, the effects of local competition, or simple aging of the facility. In the case of the converted Holiday Express at MSY, Laurus's chief investment officer, Austin Khan, observed that the "extensive renovation program will enhance the hotel's brand in a well-performing marketplace, as well as increase the asset's performing value."[5] Whether that prognostication proves out over the long run remains to be seen, but it raises the question of whether conversions generally improve hotel performance.[6] At least one recent study casts doubt on the correlation between conversion and improved performance,[7] but in the absence of empirical analysis, this issue remains to be settled.

I report here on the results of the study my colleagues and I conducted in which we analyzed the effects of brand conversion on hotel performance.[8] Because hotel conversion occurs with great frequency, the lodging industry provides an excellent "laboratory" for this investigation. Indeed, it was industry analyst Mark Lomanno who calculated in 2006 the statistic I cited at the outset—that one-third of all hotels had changed brands since opening.[9] With roughly five million hotel rooms in the U.S. having an average replacement value of $122,000 per room, my co-authors and I estimated that somewhere near $200 billion worth of hotel assets in the U.S. alone have changed brand names.[10] In this study, we used multiple performance measures to gauge the effects of conversion, including occupancy, room rate, revenues, and profits.

The Importance of Brand Positioning

For any given product category, a brand positions a product in the consumer's mind in a way that enables the consumer to differentiate it from other products in that category, while offering cues that create expectations about the product's level of quality or specific attributes.[11] In the context of our study, this means that consumers with information about a given brand's reputation or image apply that information to a specific hotel property to infer the property's attributes as a place at which to stay for the night. If they believe the brand has a reputation for providing quality service at a reasonable price, they will infer that a hotel under that brand name will perform according to those expectations. Conversion breaks the link to the original brand in the consumer's mind, replacing it with a link to the new brand, so that now the consumer perceives the hotel as likely to deliver the value proposition associated with the new brand, even though the property is in many ways the same facility in

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2 www.str.com/Media/Default/Documents/STRChainScales.pdf

3 Chekitan S. Dev, *Hospitality Branding* (Ithaca, NY: Cornell University Press, 2012).

4 www.wsj.com/articles/hotel-operators-ready-to-rumble-on-upgrades-1445360360.

5 *Ibid.*

6 In this report I focus on conversion of a hotel property that involves switching from one hotel brand to another.

7 See Björn Hanson, Anna S. Mattila, John W. O'Neill, and Yonghee Kim, "Hotel Conversion and Rescaling," *Cornell Hospitality Quarterly*, Vol. 50, No. 3 (August 2009), pp. 360–370.

8 Yi-Lin Tsai, Chekitan S. Dev, and Pradeep Chintagunta, "What's in a Brand Name? Assessing the Impact of Rebranding in the Hospitality Industry," *Journal of Marketing Research,* in press.

9 Mark V. Lomanno, "Significant Portion of Industry Involved in Conversion Activity," *Hotel & Motel Management*, Vol. 221, No. 18 (2006), p. 14.

10 Tsai, Dev, and Chintagunta, *op.cit.*

11 C. Whan Park, Benard J. Jaworski, and Deborah J. McInnis, "Strategic Brand Concept–Image Management," *Journal of Marketing*, Vol. 50, No. 4, 1986: 135–145; and Durairaj Maheswaran, Diane M. Mackie, and Shelly Chaiken, "Brand Name as a Heuristic Cue: The Effects of Task Importance and Expectancy Confirmation on Consumer Judgment," *Journal of Consumer Psychology*, Vol. 1, No. 4 (1992), pp. 317–336.

Exhibit 1

Brands in treatment group

Brands before rebranding		Brands after rebranding	
Adam's Mark	Independent	Aqua Hotels & Resorts	La Quinta Inn
Amerisuites	Inns of America	Baymont Inns	Loews
Aston Hotel	La Quinta Inn	Best Western	Marriott
Baymont Inns	Loews	Coast Hotel	Masters Inn
Best Western	Mainstay Suites	Comfort Inn	Millennium
Candlewood Suites	Marriott	Country Inn & Suites	Mokara
Clarion	Omni	Courtyard	Motel 6
Comfort Inn	Outrigger	Crowne Plaza	Omni
Country Inn & Suites	Pan Pacific	Doubletree	Park Plaza
Courtyard	Quality Inn	Embassy Suites	Preferred
Cricket Inn	Radisson	Extended Stay America	Quality Inn
Crowne Plaza	Ramada	Fairfield Inn	Radisson
Days Inn	Red Lion	Four Points	Red Lion
Doubletree	Regal	Four Seasons	Red Roof Inn
Embassy Suites	Ritz-Carlton	Hilton	Renaissance
Extended Stay America	Sheraton	Holiday Inn	Residence Inn
Four Points	Staybridge Suites	Homestead	Rosewood
Hampton Inn	Super 8	Hotel Indigo	Sheraton
Harvey Hotel	Swissotel	Hotel Monaco	Staybridge Suites
Hawthorn	Travelers Inn	Hyatt	Super 8
Hilton	Wellesley Inn	Independent	Travelodge
Holiday Inn	Westcoast	InterContinental	Waldorf-Astoria Collection
Howard Johnson	Westin	JW Marriott	Wellesley Inn
Hyatt	Woodfield Suites	Joie De Vivre	Westin
	Wyndham	Kimpton	Wyndham

the same location.[12] Thus, following conversion, the consumer's purchase intention will strengthen or weaken depending on the perceived difference in quality or value between the old brand and the new brand.

Consumer purchase intentions reflect another aspect of consumer perceptions. While shopping for a hotel at a given destination, the consumer will weigh information about the property against his or her understanding of the brand's value proposition and book a room if the property seems likely to deliver on the brand's promise. The perceived fit between brand and product reflects two elements. The first is "product feature similarity" and the second is "brand concept consistency."[13] Brand concept consistency, the more relevant factor for the purposes of our study, involves the perception that a hotel's concrete and abstract features enable it to embody the brand concept, reflecting the perceived fit of the hotel with the brand. The better the perceived fit, the more likely it is that a consumer will form the intention to book a room at the hotel.

[12] Keshav Prasad and Chekitan S. Dev, "Managing Hotel Brand Equity: A Customer-Centric Framework for Assessing Performance," *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 41, No. 3 (August 2000), pp. 22–31.

[13] C. Wan Park, Sandra Milberg, and Robert Lawson, "Evaluation of Brand Extensions: The Role of Product Feature Similarity and Brand Concept Consistency," *Journal of Consumer Research*, Vol. 18 (1991, pp. 185–193.

These considerations led us to adopt the first major element of our study design, which separates the effect of the brand itself from the hotel's fit with that brand. In this analysis, how conversion affects hotel performance appears to be a function of **(a)** the brands themselves and **(b)** the fit between the brands and specific hotel properties (which we call "property–brand fit"). Thus we wanted to decompose the overall effect of conversion on hotel performance into the brand effect and the property–brand fit effect.

Data

We compiled our data from national surveys of the hotel industry conducted annually by PKF Hospitality Research from 1994 through 2012. PKF's survey collects information from the annual financial statements of individual franchised hotel properties, as well as the business name, brand affiliation, location, and physical characteristics of the participating hotels. The operating and financial data include the average revenue per room, or ARR, a measure similar to ADR, each hotel's number of rooms, number of rooms occupied, operating expenses, marketing expenses, management fees, and operating revenues. To ensure that we were able to distinguish the effects of conversion from those of other factors, for every hotel that converted during the period 1996–2010, we collected two years of data from before and two years of data from after the conversion.

Hotels that converted formed the treatment group for the purposes of our analysis, while the control group consisted of hotels that were matched with hotels from the treatment group but did not convert during the same time period. Control hotels were located in the same metropolitan statistical areas (MSAs) as those in the treatment group.[14] However, we excluded from the control group hotels in the same ZIP code as any treatment group hotel to avoid comparing hotels in direct competition, which could confound the conversion effect we estimated if the hotels were exposed to similar demand shocks.[15] On the other hand, we included hotels in the control group that were located in markets that had no converted hotels, which helped to improve the accuracy of our estimates of certain control variables in our analysis.

Our treatment and control groups represented most of the major brands in the lodging industry, as shown in Exhibit 1 (previous page). We identified 260 hotels in the treatment group (2,632 annual observations), and 2,750 hotels in the control group (19,775 annual observations). Although the hotels in the two groups were largely comparable along most relevant performance dimensions, we noted some differences between them prior to conversion. For instance, our treatment group hotels were on average 29 rooms larger than those in the control group, and more hotels in the treatment group than in the control group had undergone renovations. However, hotels in the treatment group generally reported lower performance measures than those in the control group, including lower average occupancy and ADR. I must note that we acknowledged two limitations of our data. First, our sample may disproportionately represent high-end hotels. Second, hotels in our treatment group converted only once. Because we focused only on the effect of one-time conversion, our study does not apply to all converted hotels.

The PKF survey does not collect information on renovations. Consequently, we constructed the renovation variable in the following way. If the property was listed on the Yahoo Travel website, we collect the year of renovation information from there. When data are not available on that site, we assume that whenever there is a substantial increase in amortized depreciation, it is due to an investment in capital or physical renovation. We checked this assumption by calling some of the hotels and verifying instances of renovation.

We compiled our franchise fee data from the biennial *Hotel Franchise Fees Analysis Guide* issued by HVS International and from the "Franchising Fees Guide" published by *Hotel Management* magazine.[16] We then converted the reported fees into the proportions of fees charged by each franchisor instead of using the absolute amounts paid, setting the fees for independent hotels at zero. Using franchise fees works well in part because those fees are set by franchisors at the national level and cannot be altered or negotiated at the property level.

Although using franchise fees proved advantageous in our study design, we are aware of at least two potential problems with this measurement. First, although a dramatic increase in a brand's franchise fee should in theory trigger some degree of conversion among its franchisees, we question whether this would occur in practice. Many franchising contracts cover ten to twenty years of operation, implying that a franchisee cannot avoid absorbing fee increases. On the other hand, we found that most such contracts include "windows," often opening every two to five years, and "early outs," enabling franchisees to terminate their contracts prior to the original terminal dates.[17] The second potential problem with using franchise fees stems

14 As noted by the U.S. Census Bureau, the Office of Management and Budget defines metropolitan statistical areas as a metro area containing "an urban core area of 50,000 or more population." See: www.census.gov/population/metro/. We also considered hotels beyond certain distances from those in the treatment group (e.g., 10 miles) and a market tract defined by STR.

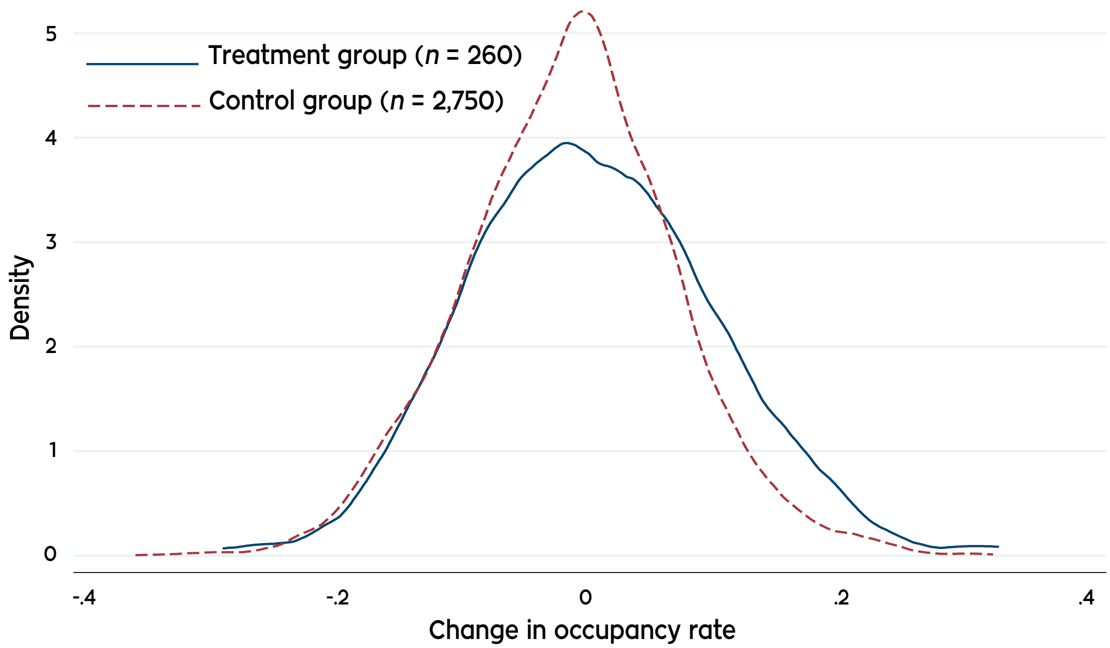
15 For more on this point, see: Sriram Venkataraman and Vridna Kadiyali, "An Aggregated Generalized Nested Logit Model of Consumer Choices: An Application to the Lodging Industry," 2005, Johnson School Research Paper Series No. 12-07.

16 According to the *2013 United States Hotel Franchise Fees Analysis Guide*, "information regarding each franchise fee structure is readily available through disclosure documents known as either a uniform franchise offering circular or franchise disclosure document. Franchisors must reveal and adhere to all terms of the franchise agreement as set forth in these documents, thereby eliminating (in theory) any potential for negotiating a more or less favorable contract."

17 See: D. K. Hayes and J. D. Ninemeier, *Hotel Operations Management*, 2nd edition (New York: Prentice-Hall, 2007), chapter 13.

Exhibit 2

Change in occupancy of treatment group compared with control group



Note: The difference between the 3-percent occupancy drop for the control group and the 0.7-percent increase in occupancy in the treatment group is significant at the $p < .05$ level. However, this comparison does not control for other factors that might affect the hotels' performance.

from the use of such fees to stimulate demand for a brand's hotels. By contract, franchise fees combine royalties to the brand with marketing contribution fees, reservations fees, frequent traveler or loyalty program fees, and other system-reimbursable expenses. Consequently, higher fees may be offset by driving more business to and generating more revenue for a hotel. We found, however, that our results pertaining to hotel performance remained robust even after excluding the marketing fees from the reported franchise fees. This, combined with the abovementioned national origins of fee hikes that render them independent of local market conditions, enabled us to proceed with our analyses.[18]

In summary, our use of time-series financial data, hotel characteristics, renovation records, and franchise fees gave us confidence that the data pertaining to our sample of hotels were free of serious selection problems for the purposes of our analysis.

Analysis

To examine how brand conversion affects hotel performance after controlling for the many abovementioned factors, we assessed conversion outcomes using the following performance measures for each hotel in our sample:

- Occupancy,
- Average daily rate (ADR),
- Number of rooms occupied,
- Total room revenue,
- Total hotel revenue (including food and beverage and other ancillary services),
- Revenue per available room (RevPAR), and
- Gross operating profit per available room (GOPPAR).

Although hotel managers naturally seek to maximize results for all these measures, they can target specific measures depending on their specific situations.

Results

To summarize our results, for our sample of franchised hotels that converted during the period 1996 through 2010, we found an increase of 6.31 percent in average occupancy, an increase in average RevPAR of 4.43 percent, and an increase in GOPPAR of 2.85 percent (see Exhibit 2 for a comparison of overall occupancy). Then, as discussed above, we decomposed the effects into brand effect and the brand–property fit effect. For

[18] Based on our sources for franchise fees, we noted that marketing and advertising fees represent a stable portion of continuing franchise fees. From 2005 through 2011, for example, marketing and advertising fees fell into a range of 20 to 27 percent of total continuing franchise fees.

Exhibit 3

Summary of brand scale conversions in sample

	Conversion to...					
Conversion from...	Economy	Midscale	Upscale	Upper Upscale	Luxury	Total
Economy	16	4	1	2	0	23
Midscale	32	30	22	25	0	109
Upscale	0	4	19	44	9	76
Upper upscale	0	2	8	34	5	49
Luxury	0	0	1	1	1	3
Total	48	40	51	106	15	260

brand effect we considered each brand's strengths for a range of performance measures, which should help hotel managers assess whether the increases in measures I have mentioned here justify the expense of conversion. For example, we found that conversion from Ramada to Holiday Inn results on average in a 9-percent increase in revenues. Although I believe that Laurus, the developer that owns the hotel conversion project near the New Orleans airport, was expecting a boost in revenue, the results of our study would give Laurus a more precise sense of what the project would likely yield in revenues.

Other factors that significantly affect occupancy rates include maintenance and marketing activities, management fees, restaurants, and physical renovations. In particular, renovation increases occupancy by 1 percent on average. On the other hand, neither the age of a property nor the number of rooms is strongly correlated with the occupancy rate. Price also had a negligible effect, as shown in another study.[19]

Decomposing Conversion Effects

Based on our decomposition of the total conversion effect into its components of brand and property–brand fit, we concluded that about 60 percent of the total conversion effect is due to the brand effect. The substantial remaining effect, which is accounted for by property–brand fit, underscores the importance of matching the brand to the property. Thus, both the brand effect and the property–brand fit effect that was described in the theoretical literature play a role in translating conversion into changes in occupancy rates.

Going another step farther, we computed brand strength based on two performance measures: RevPAR and occupancy rate. The results show that brands that have strong occupancy rates also have strong RevPARs (not entirely a surprise given that occupancy is a factor of RevPAR). In that context, we were also interested in understanding what happens when hotels switch brands. This is the calculation that gave us the result mentioned above, that switching from a Ramada Inn to a Holiday Inn increases RevPAR by 9 percent on average. This switch also improves the typical occupancy rate by 5 percent.

We then wanted to see whether there was any correlation between brand strength and price tier. We used the chain scales defined by STR to divide the 57 available brands into economy brands (10), midscale brands (17), and upscale or luxury brands (30).[20] The results were mixed. Upscale and luxury brand conversions exhibited higher RevPAR but not higher occupancy rates, while economy brand and midscale brand conversions both exhibited significantly higher occupancy rates than upscale and luxury brands. This suggests that conversion to a higher scale may yield mixed results, and hotel or brand managers may view such decisions differently depending on which measure needs improvement.

Heterogeneous Conversion Effects

Given the complexity of the relationship between a hotel and a brand, the challenges involved in analyzing the effects of brand conversion include, as I have mentioned, various sources of heterogeneity that represent differences that might affect the results obtained with our models. We conducted these analyses by introducing terms to represent fit between the conversion indicator and brand characteristics (for both origin and destination brands) on the one hand, or property characteristics on the other hand. While we believe we found useful results, in some cases the number of properties involved was small, so the estimates could not be highly precise.

Cross-Brand Heterogeneity

We investigated three scenarios that involve cross-brand heterogeneity: **(1)** when a hotel changes its chain scale or price tier as

[19] See Linda Canina and Steven Carvell, "Lodging Demand for Urban Hotels in Major Metropolitan Markets," *Journal of Hospitality and Tourism Research*, Vol. 29, No. 3, 2005: 291–311.

[20] For the definitions of hotel chain scales, see: www.strglobal.com/resources/gloissary/en-gb.

a result of conversion; **(2)** when a hotel converts but remains under the same brand umbrella; and **(3)** when an independent hotel affiliates with a brand. The last case does not involve a brand-to-brand comparison of a well-known franchise, of course, but it does involve a hotel's at least adding a brand name, together with the added revenues and expenses that go with a franchise agreement.

Changing the scale. Thus, our analysis gives an indication of what happens when a hotel rebrands to a higher tier, for example, a Ramada Inn becomes a Radisson, thereby shifting from a midscale to an upscale hotel, or when it moves to a lower tier, say, a Motel 6. Our results suggest that moving upscale in price tier may be problematic, whereas a shift from a higher price tier to a lower one is more likely to improve the hotel's performance. Our sample of 260 hotels that converted included 152 that switched chain scale, as shown in Exhibit 3, on the previous page. Of these, 43 affiliated with lower-scale brands while 109 shifted to higher-scale brands. The conversion effect proved to be strongest when hotels shifted downscale but becomes weaker when the new brand is either at the same scale or represents an upscale shift.

These results appear to be due primarily to the brand effect. Controlling for that effect renders the conversion effect insignificant for hotels that remain at the same scale and becomes negative for hotels that move up in scale. However, the effect is significant and positive for hotels that switch to a lower price tier. These effects may be due to the expectations that the conversion creates in consumers' minds. Even though a downscale move implies less service and fewer amenities, a given property probably will still have some services or physical attributes left over from the higher tier brand, leading to greater guest satisfaction in the downscale version of the hotel. Conversely, an upscale switch will create higher expectations in guests that the former midscale property may be unable to meet, at least in the short term (since it still operates in the same physical plant, albeit renovated and possibly upgraded). An upscale shift might also cause confusion about a hotel's market positioning, perhaps lowering previously strong evaluations.[21]

Remaining under the brand umbrella. There are cases of conversion in which a brand manager values some attributes of a particular hotel—including consistent performance or an attractive setting or location—and therefore offers a potential hotel conversion candidate an affiliation with another brand within its portfolio. We observed such a conversion occurring with about 29 percent of the hotels in our treatment group. Among the benefits of such a move, the hotel can continue to utilize the same reservations system, the same loyalty program, and in some cases the same revenue management system—but not the same franchise fee. To test these effects, we separated the effects of conversion under the same brand umbrella (applying to 57 of the hotels in the treatment group) with the effects of changing to a different brand family.[22] Based on our results, from a hotel's perspective, the best conversion strategy is to switch to another brand umbrella. Even after controlling for brand effects, the hotels in the treatment group that switched to another brand's umbrella enjoyed positive conversion effects, whereas the within-umbrella conversion effect was insignificant. We surmised that these hotels were able to find better matches or brand concept consistency outside of their original brand umbrellas.

Independent vs. branded hotels. Research has long suggested that independent hotels can enjoy a number of benefits by affiliating with a brand. Apart from the marketing value of the brand name, a newly branded hotel will likely receive managerial advice and training, not to mention capital it can use to improve the property.[23] Moreover, affiliating with a large brand is likely to drive up demand if for no other reason than making it easier for customers to find the hotel's location and pricing information.[24] Affiliating with a brand should also benefit a hotel with more robust and better-coordinated marketing, advertising, and loyalty programs. On the other hand, in addition to the franchise system fees, the hotel will sacrifice some flexibility in pricing, promotion, and perhaps in operations.

To test the effects of all types of brand conversion, including switching from or to an independent hotel, we analyzed three types of conversions: brand-to-brand (which we labeled "B2B," of which there were 219 in our sample), brand-to-independent (B2I, 15 in the sample), and independent-to-brand (I2B, 26 in the sample). We estimated separate conversion effects for each of these categories, but we did not decompose these effects into brand effects and brand–property fit effects. Acknowledging that that sub-samples were small, the results show that B2B increased occupancy by 6.96 percent and I2B conversion by 6.74 percent. B2I conversion, on the other hand, decreased occupancy by 5.04 percent. There was a nominal increase in ADR (in dollar terms) when hotels converted from brand to independent, but this result was not statistically significant, possibly due to the small sample size of B2I hotels.

Within-Brand Heterogeneity

Our final investigation of the interplay of heterogeneity with conversion involved within-brand heterogeneity. We wondered

21 This result would be consistent with the findings of: Chung K. Kim and Anne M. Lavack, "Vertical Brand Extensions: Current Research and Managerial Implications," *Journal of Product & Brand Development*, Vol. 5, No. 6, 1996: 24–37.

22 Forty-three of the 57 within-umbrella conversions involved the Hyatt, Hilton, InterContinental, and Starwood groups. In most of these cases the shifts remained in similar price tiers.

23 Such benefits were confirmed decades ago by: Paul Ruben, "The Theory of the Firm and the Structure of the Franchise Contract," *Journal of Law and Economics*, Vol. 21, No. 1, 1978: 223–233.

24 See: Peter A. Diamond, "A Model of Price Adjustment," *Journal of Economic Theory*, Vol. 3, No. 2, 1970: 156–168.

whether such specific hotel attributes as location in an urban versus a non-urban setting, or offering an all-suites room set versus offering no or limited suites, would change the conversion effect. We therefore coded for location (i.e., urban or non-urban) and amenities (i.e., all-suites or not-all-suites) as binary variables and then interacted that feature with the conversion variable. For the 64 urban hotels in the sample, we found that in urban locations there tends to be an positive conversion effect. We also saw a positive conversion effect in the 85 all-suite properties that switched brand (driven by a number of AmeriSuites that rebranded to Hyatt during this time period).

Conversion effects on other measures. In addition to occupancy, our analysis of the effects of conversion included absolute occupancy or total number of rooms sold, total room revenue (excluding ancillary services such as restaurants or spas), total revenue, and RevPAR. The results for these measures were largely consistent with the results for occupancy rates, with room revenue in the treatment group, for instance, increasing by 4.43 percent following conversion. This increase could result from the increase in absolute occupancy or from the increase in ADR of $9.24 on average.

Competitive Effects of Conversion

Having completed our analysis of how brand conversion affects hotels, we then investigated the effects of conversion on nearby, unconverted hotels to understand better how one hotel's conversion might affect demand for rooms at competing hotels.[25] We found little if any effect of the conversion of hotels on their direct market competitors. For this exercise we reconstructed our sample to include hotels that had previously been excluded, namely, those located in the same ZIP code as one of the converted hotels. This generated a new treatment group consisting of 266 hotels located in a market in which another hotel converted. The control group of hotels that did not convert remains the same—these hotels were by definition not located near a converted hotel.

Summary and Key Implications

The results of our study indicate that a conversion can bring performance benefits to a hotel. We summarize our main results as follows:

1. Conversion generated, on average, an approximately 6-percent increase in hotel occupancy.

2. About 60 percent of this occupancy increase can be attributed to the brand (4%), with the balance (2%) explained by the fit between the brand and the property.

3. Converted hotels' revenue improved by about 4 percent, ADR by $9, and GOPPAR improved by 3 percent.

4. Hotels that converted realized an average increase of $163,000 in gross operating profit.

5. Hotels that converted from brand to brand, or independent to brand, increased their occupancy. Hotels that converted from brand to independent decreased their occupancy.

6. While there was a nominal drop in ADR for hotels that converted from independent to brand (by $13), and an increase in ADR for properties that converted from brand to independent (by $6), these changes were not statistically significant, most likely because our sample sizes of B2I hotels and I2B hotels were small.

7. In the sample, brands such as AmeriSuites (now fully converted to Hyatt, probably for good reason) and Days Inn have lower brand strength, whereas brands such as the Omni, Hilton, and Marriott have higher brand strength.

8. Brands in the upscale or luxury tier have the greatest brand strength as measured by revenue per available room but not in terms of occupancy.

9. In examining conversion within and across price tiers, the effect of conversions was the highest if the hotel goes downscale to a lower price tier, but the effect is weaker if the hotel stays in the same scale or moves upscale. After controlling for brand effects, the results indicated no change in performance if the hotel stayed in the same scale, were significantly positive if the hotel switched to a downscale brand, and were negative if the hotel switched to an upscale price tier. In that regard, when a hotel converted to a higher price tier, it experienced a 6-percent increase in RevPAR, while a hotel that converted to a lower price tier experienced an 11-percent increase in occupancy, on average.

10. Hotels that converted to a brand outside their original brand umbrella experienced an increase in performance, but hotels that stayed in the same brand family experienced no increase in performance.

11. An analysis of the three types of conversion—brand to brand (B2B), brand to independent (B2I), and independent to brand (I2B)—shows increased occupancy for B2B and I2B hotels, while occupancy for B2I hotels decreased. This result implies that branded hotels in our sample attract more travelers than independent hotels. If the reduction in costs associated with being affiliated with a brand exceeds the reduced income from the occupancy reduction, however, it may be worthwhile for the hotel to become independent. Similarly, an independent hotel contemplating joining a brand's franchise can trade off the increased revenues with the increased costs.

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25 See Kusum L. Ailawadi, Donald Lehman, and Scott Neslin, "Revenue Premium as an Outcome Measure of Brand Equity," *Journal of Marketing*, Vol. 65, No. 1, 2003: 71–89.

12. Converted urban hotels experienced higher levels of performance than did non-urban hotels.

13. All-suite hotels that converted experienced higher levels of performance than non all-suite hotels.

14. Renovation increased occupancy by 1 percent, regardless of brand status.

15. A hotel that converted had no effect on the performance of other hotels in its ZIP code.

Practical Implications

The financial implications of these results could be quite significant. Returning to Mark Lomanno's analysis, for the five-year period of 2002 through 2006, 111,000 rooms were rebranded, or 22,200 rooms per year, covering approximately 0.44 percent of the total U.S. hotel inventory of 5 million rooms.[26] The American Hotel and Lodging Association's website (ahla.com) states that the national average hotel occupancy is 62 percent, and the national average daily occupied room rate is $110. From these data, the pre-conversion room revenue for these 22,200 rooms would be $553 million (22,200 rooms × 365 days × 62% occupancy × $110 ADR). An expected 6.3-percent increase in occupancy of these hotels after rebranding (from 62% to 66%) would result in an annual post-conversion room revenue of $590 million (22,200 rooms × 365 days × 66% occupancy × $110 ADR), an increase in room revenue of $37 million per year, or $1,667 per room per year.

These study results could cause owners to ask for shorter franchise contracts with multiple opt out clauses to adapt to changes in market dynamics that may necessitate a brand change (with the prospect of higher occupancy). Brand managers, on the other hand, could push for longer contracts and more lock-in clauses with commensurate incentives for the owners who commit to lengthy agreements. Developers will prefer to build standard or "cookie cutter" hotels that are easily converted from one brand to another, while franchise representatives could argue for distinct features (e.g., the "non-lobby" popular in some brands) to fit their brand position. Operators could push for more generic amenities or brand standards they can easily transition from one brand to another, while quality assurance managers who monitor brand standards will argue for specific amenities and services which make their brands distinct (e.g., a spa, 24-hour room service). As the financial impacts of conversion become more widely known, brand by brand with the use of larger samples, consultants will have a much better idea of how much value a brand adds to a particular hotel to compare it to the amount the brand extracts (e.g., via royalty, marketing, and reservation fees) to help their clients negotiate better franchise terms. Likewise, brand leaders will be better able calibrate their franchise fees in line with the value they add to a hotel. Finally, an opportunity exists for research firms to begin providing periodic reports of hotel brand strength via a hotel brand index (similar to a RevPAR index for a hotel) with the RevPAR indices of all hotels affiliated with a brand rolled up into a global index to give owners, brand managers, developers, consultants, and financiers a data-based comparison of one brand with another.

In summary, hotel industry executives now have empirical support for the effects of brand conversion on a hotel's performance. This research-driven insight can inform the negotiation between hotels owners and the brands with which they affiliate. ■

[26] Lomanno, *op.cit.* See: www.ahla.com/content.aspx?id=36332; viewed August 15, 2014.

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