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Abstract

To understand today's hospitality industry, executives need to recognize its international dimension. In this, the first part of a two-part article on the international dimension of hospitality, the author considers the forces driving hospitality's internationalization, the advantages drawing foreign investment into the North American market, and the patterns of expansion of American firms in overseas markets. The article is excerpted from *Introduction to Management in the Hospitality Industry*, New York: John Wiley & Sons, 1992.

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Managing International Hospitality

by

Thomas F. Powers

To understand today's hospitality industry, executives need to recognize its international dimension. In this, the first part of a two-part article on the international dimension of hospitality, the author considers the forces driving hospitality's internationalization, the advantages drawing foreign investment into the North American market, and the patterns of expansion of American firms in overseas markets. The article is excerpted from Introduction to Management in the Hospitality Industry, New York: John Wiley & Sons, 1992.

Transportation is faster and less expensive, and instantaneous communication has become common. Along with these trends, world travel has increased dramatically. The hospitality industry has become a global industry. Investment by foreign companies in North America has risen dramatically and American brands are going overseas.

In the trade press and at hospitality meetings across North America, increasingly the talk is of a global hospitality industry. Gregory R. Dillon, executive vice president of Hilton Hotels, speaking at a conference on hospitality investment, put it this way:

The world is getting smaller and smaller and smaller. We're no longer living in a world of seven far flung continents with close to 200 independent countries living to some extent isolated and independent of each other. Today--and even more tomorrow--whether we like it or not--believe it or not--the economies of the world, though still decidedly competitive, are beginning to interact more and more.

The philosophies of the world's peoples are coming closer and closer together. The language barriers are beginning to crumble. By virtue of fast intercontinental travel, telecommunication advances, and computerization we are only hours or minutes away from every place in the world. As has been said earlier, the world is becoming globalized.¹

It is, however, more accurate to speak of internationalization than globalization.² That is, while there is already movement toward a single world economy--and perhaps even some day a world government--that is a process which is still in its early stages. Although countries are increasingly involved in regional economic and

political alliances there is, in fact, continuing stiff competition between nations. Given the potential for "tariff wars" and other restrictions of trade growing out of rivalry between trade blocs, it is perhaps too early to think of the globe as one world.

Moreover, the actions of the blocs are typically dictated by the will of the strongest nation or nations within the bloc. The word international as versus global is preferred because it emphasizes the degree to which nations are still the principal actors on the international stage. It is useful, as a starting point, to try to understand the forces which lie behind the internationalization of hospitality: decreasing significance of national boundaries, such as common markets and free trade areas; increasing indifference of consumers to national identity of goods and services; free flow of capital; ease of evading regulation in international business; immigration, both legal and illegal, south to north; and ease of communication, with phones, faxes, and computer networks.

Boundaries Are Dissolved

During the 1980s the 12 nations of the European Economic Community (EEC) resolved to develop a single regional economy by 1992.³ They acted in response to increasing competition from the U.S. and Japan, as well as to their own self interest in working more closely together. The increasing success of this union was one of the forces which gave impetus to the aggressive development of other trading blocs such as the Canada-U.S. free trade agreement and similar agreements in other regions of the world as well.

The EEC is removing restrictions not only on trade, but on the movement of capital and labor. As a result, the 1992 EEC marketplace for sellers is made up of 320 million consumers. The outlook for the future size of the European economy is even stronger. If the countries belonging to the European Free Trade Association (EFTA),⁴ which has close trading relations with the EEC, are included, the total market measures 350 million. Beyond that, there are 140 million East Europeans, 285 million inhabitants of the former USSR, and 50 million Turks, all hoping to join or at least achieve a close working and trading relationship with the EEC.

Whether it is 320 million, 350 million, or the nearly one billion people envisioned in the next generation, the European market is huge compared to even the largest European national market, Germany, with 78 million people. The very size of the market is an inducement to economic cooperation because of the economies of scale that the much larger market offers. The competing bloc in North America will have over 350 million consumers if only the U.S., Canada, and Mexico are included. Brazil, Chile, Argentina, and Venezuela have also indicated an interest in participating in an "Americas" trading bloc, so there is the potential for an even larger market further into the future. The Pacific Rim, more an idea at this point than a trading bloc, nevertheless has a population of nearly a billion without China, and roughly 2 billion with it.

There are attractions other than just a large market which explain the way in which national economies are giving way to regional and international marketplaces. One very strong force is the increasing indifference of consumers to the national identity of goods and services. As one international consultant put it:

It does not matter to you that a British sneaker made by Reebok (now an American owned company) was made in Korea, a German sneaker made by Adidas in Taiwan, or a French ski by Rosignol in Spain. What you care about most is the product's quality, price, design, value, and appeal to you as a consumer. My observations over the past decade seem to indicate that the young people of advanced countries are becoming increasingly nationality-less and more like "Californians" all over the Triad Countries--(that is) the United States, Europe and Japan--that form the international economy.⁵

Today KFC is in Tiananmen Square, Nathan's Famous (hot dogs) is in Red Square, and a British company struggles to revitalize a flagging Burger King in North America.

Financial Assets Are Mobile

Increasingly the flow of international capital ignores national boundaries. The mobility of financial assets is helped along by almost instantaneous worldwide communication. This mobility of capital helps further break down international boundaries or render them increasingly irrelevant. Burger King, for instance, and Holiday Inn are both brand names as "American as apple pie," yet they are now British-owned companies, just as that pride of grand hotels, Westin, is controlled by Japanese. In these circumstances, what does national identity mean in the business world--or the world of hospitality?

National governments from time to time become alarmed at the advantages that seem to accrue to one trading partner and they try to bring pressure to bear to right that perceived imbalance. Pressure from the U.S. government, for instance, to increase shipments of beef to Japan became intense in the late 1980s. At that point,

Japanese importers such as Zenchiku Ltd. (began) aggressively buying up American ranches, feedlots, and packing plants. They and many other traders will soon be shipping in more beef from the United States than Americans do today, but it is not clear in what sense that represents a real increase in American exports, since these are really Japanese exports from America.⁶

Another factor undermining national boundaries is immigration, both legal and illegal, from the less-developed countries of the "South," such as Mexico, Southern Europe, Africa, and Southeast

Asia, where population is plentiful, wages low and unemployment high. More developed nations in the "North," the U.S. and Canada, Western Europe, and Japan, need labor in good economic times and admit immigrants to supply that need. Because wages and opportunities are better in the "North," illegal immigration is a continuing problem. The U.S. Immigration Service estimates, for instance, that two million Mexicans enter the U.S. illegally each year?⁷

In the EEC, moreover, immigration from southern member states such as Spain, Portugal, and Greece to their more prosperous northern neighbors will be entirely legal. Europe, too, faces massive illegal immigration from North Africa, the Middle East, and Eastern Europe. Some estimates are that up to 30 million Soviet citizens are ready to move, for instance.⁸ Clearly, with continuous legal and illegal migration of huge numbers of people each year, the meaning of borders becomes questionable.

Finally, the ease of communication by phone, fax, and computer networks has made possible the information flows needed for the management of world wide companies. Management reports, transfers of funds, and company directives can all be transmitted almost instantaneously. The world has become smaller.

Market for Hospitality Has Become Internationalized

The list of large U.S. companies whose foreign ownership could open their "national status" to question can be added to often. For instance, the largest "hard budget" motel chain in the U.S., Motel 6, is owned by France's aggressive lodging company, Group Accor. But the U.S. is not the only country so penetrated. Fully 45 percent of the British budget lodging chains will be in foreign hands by 1992.⁹ The largest fast food chains in Canada, Japan, and Europe are all 50 percent owned by--and franchisees of--an American company, McDonalds.

One of the largest Kentucky Fried Chicken franchisees worldwide is a Canadian firm, Scotts Foodservice. Scotts, which does business in both the U.S. and Canada, was until recently the fourth largest U.S. franchisee of KFC. The hospitality industry in virtually all developed countries has become internationalized. Companies foreign to the host country own some operations, but host country investments control operations in other countries, too. Increasingly, consumers buy what they want; investors invest where they wish.

There are a number of factors which lead companies to invest in North America; the principal ones are fluctuating currency values, large market size, security of investment, and the availability of management skills and systems.

Currency fluctuations have made the purchase of assets in the U.S. attractive to foreign investors. When the dollar is low relative to, for instance, the yen, the purchase price of dollar assets--when stated in yen--look very attractive to Japanese investors. Since the dollar's value does fluctuate, Japanese investors can assume their

investment will be worth more--in yen--when the dollar rises. In effect, foreigners have been buying North American companies with what were--for them--50 and 75 cent dollars.

Currency fluctuations are only a part of the story, however. Because of the relatively high standard of income, the U.S. market of some 245 million people has been for a long time the largest market in terms of buying power. The U.S. will retain this distinction because of its continuing high average income even after 1992, although the EEC and, for that matter, the former USSR countries, China, and India, will have larger populations. Buying into the profits of the huge and prosperous U.S. market has made a lot of sense for overseas investors.

North America Is More Secure

Not only is the North American market more prosperous than most, it also offers a more secure haven for international investment. A truly radical government, or even the violent overthrow of a government, is a distinct possibility in many countries. In contrast, the U.S. seems like a steadier ship politically, and one possessed of vast natural resources. This makes the U.S. less subject to foreign pressure than many smaller countries. While the U.S. dollar fluctuates in value against other currencies, the U.S. Federal Reserve System "is the closest thing there is to a world wide central bank," and the U.S. dollar "accounts for more than one third of the world's supply of usable money."¹⁰

Foreign buyers are often satisfied with lower rates of return than American asset holders expect. The Japanese, for instance, have become famous for their willingness to accept modest returns from the early years of an investment in order to secure a strategic position and in hopes of larger returns in the more distant future. Moreover, foreign tax rules can make a seemingly expensive purchase a good investment after sorting out the tax consequences of the purchase in the home country of the buyer.

In buying North American companies, many overseas companies seek to gain the advantage of North America's highly developed management systems in accounting and cost control, reservation referral systems, and marketing. North American hospitality brands, moreover, have world wide appeal and can be used to spearhead expansion in other parts of the world. To give just one example, after Grand Metropolitan bought Burger King, it proceeded to acquire 20 Wimpy operations in Great Britain from a restaurant company there. The purpose of the acquisition was to convert those units to Burger Kings and to take advantage of the power of the Burger King brand name.¹¹

Whenever the value of the dollar is low against other currencies, U.S. firms have been less active in purchasing foreign firms. In fact, however, a great deal of acquisition activity was carried out by U.S. firms in the 1960s and 1970s. Even in the face of a lower dollar, U.S. companies have not been entirely absent from the market in

recent years, particularly in "gateway cities," those which have a dominant position in a country in the way that Paris does in France or Tokyo in Japan. More often, American firms have entered the market either as franchisors or through a joint venture with a partner firm from the host country where the venture is located, thus securing an advantage in adjusting to the local market as well as to local social and political environments.

American Hospitality Expands Abroad

U.S. firms are, indeed, expanding into the international environment. A relatively small number are expanding through outright ownership. More are moving abroad through franchising, joint ventures, strategic alliances, management contracts, or some combination of these.

When a company moves into a foreign market, all the rules change. Employment practices differ; supervisory skills need to take account of the local culture. Government rules and procedure ranging from zoning to sanitation to labor, as well as many other key areas of concern, are different. In order to minimize problems arising from national differences, a country that has a high degree of similarity to the U.S. should be chosen, which probably explains why Canada is often the first country selected by U.S. firms for expansion. Even in a country with as many similarities as Canada, however, culture, laws, and practices differ; and, therefore, a key step is to hire local nationals, wherever possible, who have the necessary local contacts as well as the required business skills. For instance, when General Mills expanded its restaurant division into Canada, it hired an executive staff of seasoned Canadian executives and undertook an aggressive management training program to develop Canadian unit management staff. In fact, there are very few U.S. nationals employed in the company's Canadian headquarters or its numerous Red Lobster and Olive Garden restaurants in Canada.

Wendy's entered Japan some years ago in a joint venture with a Japanese company. In 1989, however, the company announced that it would begin opening company owned units in Japan to gain more control over the Japanese operation's marketing program.¹² Ownership of an operation does confer tighter control over the business.

A different way to bridge the gap to operations in another country is by obtaining management know how when the assets of a company are purchased, that is, by acquiring a company and convincing its management to remain in place. U.S. travel agencies, for instance, are expanding into Europe by acquiring large firms,¹³ and many European and Japanese firms have chosen this method to enter the U.S. market as in Grand Metropolitan's purchase of Burger King.

Franchising Is Popular Overseas

Probably the most common U.S. approach to overseas expansion is franchising. Kentucky Fried Chicken operates more restaurants

outside the U.S. than any other U.S. chain, and virtually all are franchised. Roughly 40 percent of KFC's stores are outside the U.S. In 1989 the 3,000th KFC outlet outside the United States was opened by KFC's Korean franchisee, in Seoul, South Korea.¹⁴ The company's largest unit is in Beijing, China, and the company's second highest volume store is in London, England.¹⁵ The overseas market has clearly been a rich one for them.

A wide variety of companies have moved their concepts overseas by franchising. Chi Chi's is active in Canada, England, Kuwait, and Luxembourg.¹⁶ Like so many companies expanding into the international market for the first time, Rax Restaurants has begun in Canada, granting area franchises to two companies whose territories will cover the whole country.¹⁷ Dominos operates over 350 stores in 22 countries. In the Japanese market, Dominos finds its speedy delivery is a unique competitive advantage in a market where food service delivery has been available for centuries. Their delivery service, moreover, uses uniformed drivers and achieves an upscale image for the company in that market.¹⁸

Hotel franchise companies are well represented overseas as well. For instance, in Japan, Quality, Ramada, and Holiday all have franchised operations; three are conventionally "American," but two of them are now foreign owned.

U.S. Can Sell Overseas

Even U.S. regional companies find they have know-how to sell overseas. Carl Karcher Enterprises, a regional restaurant chain concentrated in the southwestern U.S., has licensed a Malaysian company to open Carl's Jr. stores in nine Pacific Rim countries. The first stores will be in Malaysia, Singapore, Australia, and Hong Kong.¹⁹ Trendy American style restaurants such as Ed Debevic's casual dining operation and Spago, an haute cuisine restaurant owned by chef Wolfgang Puck, have been successfully franchised in Japan.²⁰

Concepts developed in the U.S. often need to be adapted to local conditions. Bonanza's English operations, for instance, look like the U.S. outlets--except for a closed circuit television located at the restaurant's entrance to tell first-time diners how to place their order and how to use the salad bar,²¹ TGI Friday's franchisee in England is a brewer, Whitbread. In Friday's operations in England, the decor is identical, but a number of Mexican dishes have been replaced with the more familiar (in England) curried Indian dishes and salad is served after the entree, as is the custom there. In addition, "TGI Fridays has made special efforts to train the naturally reticent British to be outgoing and service oriented."²² In Japan, McDonalds has introduced a Teriyaki McBurger in response to local competition,²³ while in France they serve wine--and in Germany, beer. The key in all these situations is to maintain the core values of the company while bending enough to offer local customers a product and service that meets their needs and preferences.

Joint ventures are separate enterprises formed between two, or sometimes more, companies to undertake a specialized venture. Usually each company involved has some ownership interest. Very commonly each brings different assets to the enterprise. One partner may bring financing, real estate, or other fixed assets, while the other partner brings know-how, expertise, a marketing, or an operating system. One partner's advantage may be know-how and contacts in an area while the other's may be know-how and management ability in a specific business. For instance, Marriott inflight catering division formed a joint venture in 1988 with Kuwait Airways, Saudi Airlines, and Gulf Air. The joint venture was aimed at establishing Marriott as an acceptable provider of Islamic meals--although it is a western company.²⁴ Another venture was formed between a Texas franchisee of Dairy Queen and an Italian company to operate Continental Dairy Queen, initially in Italy and, in time, in Spain and Portugal as well. The new company, of course, was a franchisee of International Dairy Queen.²⁵

The international division of Hilton Hotels, Conrad International, is building luxury hotels in a series of joint ventures with local partners in places such as London, Dublin, Hong Kong and Monte Carlo.²⁶ Hilton International and the rights to the Hilton name outside the United States were sold some years ago by Hilton-U.S.

With the opening of Russia and Eastern Europe, some joint venture partners have been government agencies. Nathan's Famous formed a joint venture between the Lenin District Catering Trust and Ziegler Enterprises, a New Jersey company specializing in business ventures in the then Soviet Union. Nathan's sells the hot dogs, for which it is justly famous, in trailers in Red Square in Moscow.²⁷ Perhaps the most widely noted entrant into Eastern Europe in recent years, however, was McDonalds.²⁸

McDonalds Made Changes in Moscow Operation

Doing business in the context of an entirely different economic and social system certainly raises the level of complexity of an international business venture to a high level. In 1976, George Cohon, president of McDonalds Canada, itself a joint venture owned by Canadian stockholders and McDonalds U.S., opened discussions during the Montreal Olympics with Soviet officials with the aim of bringing McDonalds to the USSR. These discussions lasted through the governments of three different Russian premiers. McDonalds joint venture partner was the Food Service Administration of the Moscow City Council. The value of local contacts was illustrated when the venture received an assist from the then premier, Mikhail Gorbachev, who introduced new legislation in the Supreme Soviet permitting joint ventures with non-Soviets.

"The same quality, service, cleanliness, and value that exist wherever there are McDonalds restaurants will prevail in Moscow," Cohon said. "A Big Mac is a Big Mac; it will taste the same whether it is served in Canada, the United States, Japan, or the Soviet Union."

Indeed, according to Cohon, what ultimately sold the Soviets on McDonalds was the business system--quality, service, cleanliness, and value--that the company had to offer. Nevertheless, McDonalds made more than modest adaptations in its business system to deliver the standard McDonalds menu.

While preserving the core values offered to the consumer, McDonalds found that the needed foodstuffs just would not be available in the Soviet Union. Accordingly, although the company relies on outside suppliers elsewhere, McDonalds and its joint venture partner constructed a 110,000 square foot food production and distribution center that can supply McDonalds basic products to the company's specific, very high quality standards. The output of the center is prodigious: 10,000 meat patties per hour, 14,000 buns per hour, and 5,000 pies per hour. The processing center will be able to supply products to other joint venture hotel and restaurant operators--and export pies to other Eastern European countries. The processing center is sized to provide the products for the 20 McDonalds units projected for the Moscow area.

To provide the raw product the center requires, McDonalds installed an agronomist on a local collective farm to supervise the growing of potatoes from planting to harvesting and persuaded farmers to grow iceberg lettuce and pickle cucumbers from imported seed.²⁹ Milk is collected from a local collective farm in McDonalds' own refrigerated dairy trucks and is pasteurized at the food production center.

The first Moscow unit to open is the largest McDonalds unit ever constructed. Located on Pushkin Square, it offers seating for 700 people on four levels, with room in the summer for another 200 in an outdoor terrace, and has the capacity to serve over 25,000 people per day. Not surprisingly, the crew of 630 people is also the largest McDonalds unit staff in the world. McDonalds, however, has been limited to sales in rubles, a currency which has little value outside the Soviet Union. Profits are being used to build a second operation, but McDonalds still faces the problem of bringing its profits home in dollars.

Strategic alliances in the hospitality industry are a type of joint venture which is aimed at a specific geographic region. These are typified, for instance, by the arrangements Radisson used to move swiftly into international markets. In Switzerland and Germany, Radisson is allied with Movenpick. These hotels are known as Movenpick-Radissons. In Hong Kong and the Far East, a similar arrangement has been made with Park Lane Hotels, and in Australia with Argus Hotels International. In India, the strategic alliance for that country is with the Indian Tourist Development Corporation, while in Mexico it is with Banamex--the National Bank of Mexico.³⁰ Choice International is seeking strategic partnerships with airlines and other travel-related companies, as well as with other hotel groups. Local partners bring such advantages as knowledge of operations and labor force conditions in their country or area as well as contacts with

government suppliers. The U.S. partner brings an international brand name, the technology of an international reservations system, and management expertise.³¹

Management Contracts Provide Growth Prospects

A management contract is an arrangement between a management company and a hotel owner that provides for the management company to operate a hotel either for a fee or for a share of the profits. Some management contracts provide for fees whether a profit is earned or not, and may or may not require investment in the property by the operator. Limiting investment is customary where the "country risk," i.e., political and economic instability, is high. Naturally, on the other hand, the owners prefer an arrangement where the operator shares in the investment risk. This kind of arrangement is common where the long run outlook justifies either a start up investment by the operator or investment of a portion of the management contract fees in the purchase of an ownership interest. Thus, for example, Stouffers has entered into a joint venture management company with Mexico's second largest chain, the Presidente Hotels. Presidente will own 51 percent of the joint venture management company and Stouffers will have 49 percent. In addition, Stouffers will gradually acquire a share in the ownership up to 25 percent of each Presidente Hotel. Stouffers' interests are clear. While Mexico's economic situation has been volatile for some years, its government has been basically stable. Six million tourists visit Mexico each year, mostly from North America. New markets are clearly opening, moreover, and European visitation has been growing at 25 percent annually since 1987. Thus, Mexico offers both Stouffers and Presidente excellent prospects for growth.³²

Combinations of franchising, joint venture, strategic alliance, and management contract are common and arrangements are flexible. Indeed, while an international franchise is a fairly standardized document and a degree of standardization is appearing in international management contracts, most partnerships and alliances are concluded on the basis of the specific interests, abilities, and needs of the partners. Thus the wide variety of combinations of arrangements is hardly surprising.

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³The EEC is made up of Great Britain, Ireland, Germany, Denmark, Netherlands, Belgium, Luxembourg, France, Portugal, Spain, Italy, and Greece.

⁴The EFTA is made up of Iceland, Norway, Sweden, Finland, and Austria.

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