

Recipes for Success: Lessons Learned From Successful Hospitality Companies

by
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After a decade of over-expansion, the hotel industry began the '90s with excess capacity and decreased demand. Since 1993, the U.S. hotel industry has experienced a turnaround which continued into 1994-1995 with good performance by most firms. However, competition will continue to be fierce and many challenges are awaiting hotel companies in a more global environment. This article examines the key elements for achieving success in a challenging hospitality industry environment while focusing on the strategies and techniques employed by some successful hotel companies during difficult times.

The hotel industry has changed dramatically in the 1990s, evolving from an industry often driven by ego and operated on tax incentives to one that has fully recognized that to achieve financial success, a hotel needs to concentrate on business strategies for survival and success.

Global competition, overbuilding, natural disasters, the impact of the Gulf War, lack of financing, and a global recession are among the factors which contributed to the negative economic environment that the hotel industry faced in the early 1990s. Upswing in demand, restructuring of real-estate debt, an improved economy, a weak dollar, and operating cost controls were the major reasons for the industry's turnaround in 1993. Industry losses of about \$5.7 billion in 1990 had turned to profits of about \$2.4 billion by 1993, according to Arthur Anderson and Smith Travel Research.¹ In 1994 and 1995 the U.S. hotel industry continued to show strength as evidenced by average room rates reaching \$67.34 a night in 1995, up 4.8 percent from 1994, according to Smith Travel. Results also showed that hoteliers earned almost \$8 billion during the past two years.²

With the nation's demand for rooms more adequately matching room supply, the hotel industry has launched its biggest building program in 15 years. However, demand growth decreased in half since the spring of 1995 and occupancy rates have been flat in the early part of 1996, for the first time since 1991. As a result, some analysts are concerned that the industry's rebound may not justify all the new construction plans that have been undertaken in the recent past.³

Lodging Operators Continue to Confront Challenges

It is evident that there are many major problems facing hotel operators as well as significant opportunities brought about by a changing hospitality industry environment. They include the following:

- The proliferation of limited-service hotels, which had been the fastest growing segment of the industry, reflects not only the budget consciousness of consumers, but the segmentation of the hotel industry into many submarkets from economy hotels to luxury hotels.
- The collapse of communism in Eastern Europe and the former Soviet Union has opened up investment opportunities worldwide. Moreover, with the world's move toward a global economy, hotel development opportunities are, and will be, available in many markets whose governments are actively seeking foreign investment.
- The number of employees for each 100 hotel rooms has decreased from 54 in 1988 to 50.5 in 1993, according to hospitality analyst Bjorn Hanson. This drop has enabled the break-even occupancy rate to fall to 64 from 65.8 percent.⁴
- Competition will continue to be fierce in all market segments and all geographic regions. In addition, the impact of government policies could slow down the amount of growth.
- There is tremendous increase in the sophistication, variety, and affordability of information technology available to hotels.
- Consumers are demanding more value for the goods and services they purchase.
- Shareholders are more focused than ever in expecting managerial actions that will result in the maximization of the firm's value.
- Travel and tourism has the makings of becoming a truly global industry. Its potential for growth has, as yet, been untapped.

In the competitive and changing hospitality industry environment of the 1990s, companies that succeed will be those who do things differently, who look for novel solutions to problems, and who overcome the rigidities inherent in mature organizations.

Business success is a broad concept which includes strategies companies employ in building a successful firm. From a financial viewpoint, success is a combination of operating and financial policies, a well implemented strategic plan, proper leadership and innovation. All of these ingredients must be put together to ensure the recipe for a company's success.

Strategic Planning is a Key Aspect for Financial Success

In developing an effective strategic plan, hotel firms must keep in mind that it will have to be changed as necessary due to new circumstances, especially those affecting the operating environment of the firm.

The development of long-term goals and objectives for the business need to address the following entrepreneurial questions:

- What do I want for this firm?
- How will I measure success?
- What are the priorities? Growth? Service? Market share?
- How can I achieve these goals?

While a new hotel must essentially deal with an action plan, an ongoing business must deal not only with an action plan but also with a reaction plan. As the business grows or the industry economic environment changes, it is clear that the company has lost sight of its original goals and objectives and how to achieve them. Corporate strategies will require financial and non-financial planning to adapt to new business economic conditions.

Strategic planning in order to be successful must be built on a positive attitude toward the changes taking place in the operating environment. Dealing with challenging economic conditions in the hospitality industry requires not only a different perspective but different leadership as well. The chief executive officer, for instance, must fully understand and prepare to change, if necessary, the firm's corporate culture.

For entrepreneurs of hospitality firms, the best strategies come from staying as close to customers, competitors, employees, and day-to-day operations as possible. As McDonalds has learned, its best ideas come not from its staff, but from franchisees, the entrepreneurs of the organization. Moreover, today's top management is fully aware that the best solutions for business problems may not come from textbooks, but from management practices conceived in a far corner of the world, and no chief executive or financial officer can afford to reject successful techniques, no matter what their country of origin. By opening their markets to foreign investors and encouraging domestic companies and investors to pursue opportunities abroad, governments are triggering a push for multinational business.

Investing in People Is a Major Aspect of Success

To be effective in the current dynamic and competitive business environment, hotel companies need to invest in people. Indeed, successful companies are spending more budgetary dollars in quality improvement and employee training. Some analysts feel that training budgets of 3 to 5 percent of sales are necessary to create and maintain a superior workforce in today's competitive marketplace.

Moreover, a good management information system will enable an organization to identify its strengths and weaknesses and make more effective use of available information. Supplying key decision makers with information needed to judge the viability of a given strategy will hold the key to growth, profitability, and ultimate financial success.

Dupont Analysis Measures Financial Success

Achieving financial success is the result of many individual decisions made continually by the firm's management. The assessment of

business performance involves the cumulative financial effects of these decisions and judgment of the results by means of comparative measures. Dupont analysis (combined with cash flow analysis) is an excellent way to measure a firm's financial success.

The primary objective of corporate management should be to maximize the value of the owner's interest in the firm. At the same time, cash flow from operations is the basis to pay dividends and to reinvest productive assets that will generate earnings in the future. The Dupont model has won recognition for its usefulness as a measure of business performance by breaking return on assets (a measure of return on investment) into two determinant parts: profit margin and asset turnover, as follows:

- **Profit Margin X Asset Turnover = Return on Assets:** A hotel firm can improve its profitability of sales (profit margin) by raising prices or lowering costs or a combination of both. When this is combined with an effective use of assets that generate sales (asset turnover), there is a direct enhancement on return on assets. An added factor to final success will be the addition of debt to the capital structure (leverage) to magnify the return on equity (another measure of return on investment often referred to as the ultimate measure of business success). The Dupont equation is then extended by adding the debt dimension as follows:

- **Return on Assets X Leverage = Return on Equity:** Accordingly, a company's financial success can be measured by using Dupont and leverage analysis since this model conveniently presents three major determinants of financial success: operating management (profit margin), asset management (asset turnover), and debt management (leverage).

Many Different Recipes for Success Exist

There are many different contributing factors to a firm's financial success. Some reasons for success include access to capital, good execution, adequate internal controls, and strategic planning. In the difficult and challenging hospitality environment of the 1990s, the need for new approaches to doing business in the industry and the development of very innovative techniques become imperative. It was the catalyst for some firms that navigated the rough waters of the early 1990s successfully, despite the treacherous conditions that the hospitality industry confronted during that time. The strategies followed by these hotel firms provide the necessary groundwork to explore universal lessons to be learned by the industry.

Marriott Provides Example

Marriott Corporation opened its first hotel in Arlington, Virginia, in 1957. However, when Marriott went public in 1968, it saw itself as an operator of public restaurants. When the late J. Willard Marriott

stepped aside as president in 1964, the company took a sharp turn toward aggressive expansion. In contrast to the steady, internally financed growth of the early years, J.W. Marriott, Jr. followed a new strategy of rapid and sustained growth, relying on the use of debt financing. It was also during this time that Marriott evolved from a restaurant company to a hospitality service leader, quite a success story if one goes back to Marriott's origin. First, it changed from a restaurant operator to a full service operator. The second step was to reposition itself in 1986 by acquiring Saga Corp., the giant contract food service company.

During the 1980s, the leverage strategy and the aggressive expansion plans gave Marriott a tremendous advantage over other hospitality firms. Marriott's name was not only at the top of the lodging industry, but by 1989 the combined food and beverage sales across the lodging, restaurant, and contract food service divisions accounted for 70 percent of the \$8.4 billion in revenues, making Marriott second only to Pepsico in total food and beverage sales.

In the 1980s Marriott outperformed the industry by a significant margin in occupancy and profitability. "Although those were not the best times for the hotel industry, which began to suffer from the oversupply of rooms, Marriott set itself apart from the industry through its clever use of financing in the form of management contracts.." Many new concepts were developed during this period, including Courtyard, Fairfield Inns, Residence Inns, and Marriott Suites.

Marriott Takes Personal Approach

Marriott's mission statement exemplified a simple and very successful philosophy: "We are committed to being the best lodging and food service company in the world by treating employees in ways that create extraordinary customer service and shareholder value.." Marriott's success had been driven by people, employees, customers, and shareholders. While nameless, faceless mega-companies were taking control of corporations, J.W. Marriott, Jr. himself owned a large percentage of Marriott, and his face greeted its customers in each room. This contributed to the above average occupancies, superior earnings, and Marriott's reputation.

Marriott's growth strategy of borrowing heavily to build hotels, which it then sold while retaining lucrative management contracts, backfired in the late 1980s. When the real estate market deteriorated in 1989, Marriott was unable to sell hotels, which led to the worst crisis in J. Willard, Jr.'s career. In December 1989, Marriott announced a planned disposal of its fast-food business and the sale of its catering division, which was perceived as a new commitment to hotel business and a means of improving the company's posture and reducing debt.

The sale of Marriott's fast food and restaurant division, which accounted for some 13 percent of the company's gross revenues, brought to a close over 60 years of the company's history. Marriott's

restructuring was based on Michael Porter's managerial theory that relying on successful strategies that were developed in the past can lead to decline, and that companies should not invest in businesses that have no opportunities for future recapture. By divesting the restaurant segment, Marriott attempted to avoid these problems.

In the early 1990s Marriott's difficulties were exacerbated by the U.S. economic recession. Despite an increase in occupancy levels and sales of nearly 11 percent, Marriott reported a 33 percent decline in earnings for the third quarter of 1991. Analysts attributed these disappointing results to a soft real estate market and to Marriott's inability to recoup development costs by selling hotels. As part of the drive to reduce massive debt, Marriott was forced to reduce capital expenditures by more than \$500 million in 1991.

In the midst of difficulties, Marriott developed an audacious plan to spin off the hotel management business from the real estate operations by creating two separate companies. Under the terms of this financial maneuver, Marriott's shareholders received a special dividend of one share of a new company, Marriott International, which was to retain Marriott's valuable hotel management and contract service business. Marriott Corp., renamed Host Marriott, retained ownership of most properties, as well as close to \$3 million in debt. Again, J.W. Marriott, Jr. was trying to transform the company into a robust growth machine in spite of being in his sixties and suffering two heart attacks. The spin off, welcomed by shareholders, was completed on October 8, 1993, after negotiations with bondholders and affirmative tax rulings.

Companies Outperform the Market

Since the split in 1993, both companies, and Host Marriott, in particular, have outperformed the market. The experiment has fitted in perfectly with the current fashion for demerger whereby investors tend to value the parts of a company at more than the whole, partly because sharper focus is believed to enhance performance. Marriott International's earnings per share and net income both rose 24 percent in 1995, while sales topped \$8.9 billion, a 6 percent increase from 1994. Return on equity was 27 percent in both 1994 and 1995.

Furthermore, Marriott is pursuing an aggressive worldwide lodging expansion plan, which added 23,500 rooms in 1995 and is expected to add 120,000 hotel rooms to its system between 1996 and the year 2000. In addition, its purchase of 49 percent interest in Ritz Carlton is "a great transaction," according to industry analyst Bjorn Hanson, "which adds the competency of back-of-the-house operations that Marriott is strong at with the front-of-the-house service that goes with the Ritz Carlton name," making Marriott a luxury segment player. Host Marriott was still reporting losses in 1995, but had substantial operational and financial gains and continues to concentrate on pursuing acquisitions in the lodging industry in the United States while making selective investments internationally.

Table 1
Dupont Analysis of Marriott (1983-1992)

Year	Profit Margin	Asset Turnover	Return on Assets	Leverage	Return on Equity
1983	4.84%	X 0.95 =	4.60%	X 3.98 =	18.31%
1984	4.89%	X 1.06 =	5.18%	X 4.15 =	21.50%
1985	4.63%	X 0.76 =	3.52%	X 4.31 =	15.17%
1986	4.13%	X 1.13 =	4.66%	X 4.48 =	20.90%
1987	3.81%	X 1.18 =	4.49%	X 5.52 =	24.78%
1988	3.50%	X 1.16 =	4.06%	X 7.52 =	30.53%
1989	2.35%	X 1.19 =	2.79%	X 9.48 =	26.45%
1990	0.61%	X 1.12 =	0.68%	X 13.17 =	8.96%
1991	0.98%	X 1.23 =	1.21%	X 12.47 =	15.09%
1992	0.98%	X 1.35 =	1.32%	X 8.82 =	11.64%

Source: Marriott Corp. Annual Reports, 1983-1992.

In 1994 and 1995 the REVPAR (revenue per available room) increased at an average of 7 percent at its full service properties. In keeping with a strategy to develop more tightly focused operations, Host Marriott Corp. completed a spin off of its concession business in 1995. The real estate company retained the name Host Marriott, whereas a new company, Host Marriott Services Corp., will manage food, beverage, and retail concessions at airports, toll plazas, and sports and entertainment complexes.

The Dupont analysis of Marriott from 1983 to 1992, the last year before the spin off, indicates how Marriott's return on equity grew in most of the '80s as a result of good operating and asset management and the magnification of return on equity through the use of positive leverage. This growth in return on investment was reversed in the period 1989-1992 due to the collapse in the real estate market, the recession, and the oversupply of rooms in the hospitality industry. Nevertheless, Marriott's spin-off strategy restored Marriott's profitability and maximized shareholders' value.

Hilton Becomes Another Success Story

In 1947 Hilton Hotels Corporation became the first hotel company listed on the New York Stock Exchange. At that time the Hilton chain was still a group of individual businesses owned by different partnerships that its founder, Conrad Hilton, had developed dating back to 1919. Going public was designed as a step to capitalize on Hilton's name and the reputation of first class hotels.

As the economy boomed in the early 1950s, Hilton prospered and purchased the New Yorker Hotel and the Shamrock Hotel in Chicago. The purchase of the Statler Hotel in 1954 was regarded at the time as "the largest private real estate transaction in history." Hilton also

pursued international expansion when Hilton International opened its first hotel in Puerto Rico, followed by great successes in similar hotels in Madrid, Istanbul, and Mexico City. Later, Hilton International was spun off into a different company and acquired by Transworld Airlines.

In 1965 Barron Hilton, Conrad Hilton's second son, became president of Hilton. Under his tenure, Hilton continued growing in the domestic market and entered the gaming industry by acquiring the Flamingo Hotel and the Las Vegas Hotel. In the late 1970s Hilton shifted its emphasis from hotel ownership to management contracts, joint ventures, and franchising. Yet, Hilton retained the family jewels, the Waldorf Astoria and Palmer House.

During the 1980s Hilton's gaming division became the greater contributor to earnings, almost all of which were derived from three properties in Nevada. By 1989 four gaming casino properties in Nevada represented approximately half of Hilton's wholly owned revenue and contributed 44 percent to its net income. During the late 1980s Hilton became involved in a refurbishing plan of over \$1 billion that included the Chicago Hilton and the Waldorf Astoria in New York. Hilton's re-entry into the international market with the opening of Conrad International Hotel and Jupiters Casino in Queensland, Australia, in 1985 was according to Barron Hilton: "...directed toward the world's major business and financial centers, gateway and capital cities, and selected resort locations."

In 1989 Hilton's board considered a full spectrum of alternatives, the possible sale of the company or its hotels, the spin off of the gaming segment, or recapitalization, "in an attempt to maximize shareholders' value." But, as economic conditions changed and the investment climate for real estate and hotels deteriorated rapidly, Hilton discontinued further exploration of a sale of the corporation since the proposals received were unacceptable.

In the early 1990s Hilton's strategy focused on extending its leadership in the gaming industry while developing Hilton Suites and Crest Hill products domestically and internationally. Since Hilton's refurbishing and expansion program during the 1980s did not rely heavily on the use of debt, Hilton found itself in a good position to face the industry's difficulties and pursue a globalization strategy, which formed the theme for Hilton's 1993 annual report.

Beginning in November 1994, Hilton explored plans to sell itself whole or piecemeal, and had pursued a plan to spin off its gambling operations from the hotel group. But in early 1996, Hilton abandoned the spin off, saying the combined company would hold greater potential for growth. This was followed by the appointment of Stephen Bollenbach, who has held top financial jobs in the hotel, gambling, and entertainment industries, as president and chief executive officer. This action was received very well by the investment community and Hilton stock has increased over 35 percent from the mid-\$70s in February 1996 when Bollenbach was appointed CEO and president of Hilton, to over \$100 in May 1996.

Bollenbach has a reputation for enhancing shareholder value by taking over or breaking up companies. He has announced that Hilton will increase its use of debt, buy upscale hotels and franchise or manage mid-market operations, strengthen ties with Hilton International Co., and grow in the gambling area.

Holiday Corp Follows Growth of Highways

Since Kemmons Wilson developed the idea for Holiday Inns in 1953 as a result of "the most miserable trip in his life," Holiday Inns growth paralleled the growth of the interstate highways. From Wilson's idea to give highway travelers reliable, consistent, moderately priced lodging, Holiday Inns grew to become the largest hotel company in the world. Its success was the result of many innovations, especially the use of franchising in the hotel industry.

In the 1970s, Holiday Corp. attempted to diversify by purchasing Continental Trailways and Delta Steamship. But in the face of deregulation and rising energy prices, these companies were sold at a loss, causing a 90 percent drop in the value of Holiday Inn stock. Wilson retired and Roy Widgardner took charge of Holiday Corp. He envisioned the corporation as a hospitality company that would provide food, beverages, and related entertainment and commercial services. By 1985 there were 1,500 Holiday Inns in the United States and 215 overseas. In addition, after merging with Harrahs, a Nevada casino company, gaming interests in Nevada and New Jersey supplied 39 percent of the operating income of Holiday Corp.

By 1987 Holiday Corp. was facing substantial pressure from takeover attempts due to the perception that the stock was undervalued. Also, product differentiation by most chains eroded Holiday's gigantic market base, and the company developed and purchased segmented brands such as Embassy Suites and Hampton Inns. In the midst of these problems, Holiday devised a recapitalization strategy that included four major components: increased leverage, resource capital intensity, unlocked appreciation of real estate through property sales, and the distribution of asset sale proceeds to shareholders.

An agreement was reached with Bass PLC, an English conglomerate, for the sale of the rights of the international Holiday Inns outside North America. Bass also agreed to cooperate on common expansion of the Holiday Inn system worldwide. As a result of the property sales, in less than one year Holiday accomplished over 80 percent of its debt reduction goal. In 1989, a second recapitalization was completed, resulting in the sale of the remainder Holiday Inn brand to Bass PLC, reduction of \$1 billion in debt, and distribution of cash to shareholders. In addition, Holiday Corp. spun off Homewood Suites, Embassy Suites, Hampton Inns, and Harrah's gaming concern to a new company named Promus.

Today, Holiday Corp., a shell company of Bass PLC, is redefining the marketplace to address changing consumer needs. Its success strategy for the 1990s has been based on the company's ability to

deliver a product quality, consistency, and value for the money. Bass has brought an ambitious global perspective to the business and created an effective brand portfolio suited to the diversity of the international marketplace.

Hospitality Franchise System Achieves Success

Hospitality Franchise System (**HFS**) has achieved spectacular success since it commenced operations in July 1990 with the acquisition of the Howard Johnson's Franchise System and the rights to operate the Ramada Franchise System. Founded by Henry Silverman with the backing of the Blackstone Group, an investment banking firm, HFS became a publicly-held company in 1992. Indeed, Henry Silverman had a unique knowledge of the hotel franchise business and a very creative deal-making ability. He saw opportunities in the recession of the early 1990s in which hotel franchisors could offer a variety of well-known hotel chains in return for fees. As franchisor of Ramada, Howard Johnsons, and Days Inn, HFS is the nation's largest franchisor of hotels and, since its acquisition of Century 21, a real estate brokerage firm, it has attempted to diversify itself by recognizing that the hotel industry has not been growing enough to sustain HFS's growth rate of 30 percent.

In creating HFS, Henry Silverman, a former leveraged buyout expert in the 1980s, made use of lessons he learned from the excesses of the past decade. HFS has low debt, and no major investment in hard assets and keeps on getting, royalties, marketing and reservation fees from its franchisees. According to a Morgan Stanley report, "HFS is one of the few companies that can actually grow without capital spending." At the same time, HFS is in possession of a huge consumer base of hotel guests that it hands over for yet more fees to major companies such as AT&T, Coca Cola, and Visa.

Since it went public in 1992 at a split-adjusted price of 4, HFS's stock value has increased dramatically. It reached over 50 in early 1996 and closed at \$47.62 on March 13, 1996. HFS's franchise fee revenue for 1995 was \$413 million, as compared to \$312.5 million in 1994. Its earnings per share were \$1.46 in 1995, an increase over the \$1.06 of 1994.

One of the key factors to HFS's success is the presence of the Patel Clan of Indian immigrants as owner/operators of many hotel brands. Approximately one third of hotels that operate Ramada, Howard Johnsons, and Super 8 names are owned and operated by Indian immigrants of the Patel Clan. At the same time, more than one half of the hotels operating under the Days Inn name are owned and operated by Patels. They have generally assumed all the capital requirements, thereby freeing HFS from the investment risk. These owners/operators of the Patel clan usually hold at least one university degree in accounting or engineering. Yet, in spite of the sophisticated knowledge, their hard-working culture does not deter them from assuming housekeeping and other hotel operating duties when deemed necessary.

Others Have Recipes for Success

Unlike many hotel chains which have followed international strategies of franchising, product segmentation, and acquisition of strategic partnerships, Hilton International was staying on a well-defined and successful route growth by adding management contracts. Readers of hotels selected Hilton International's Chairman and Chief Executive Officer Michael Hirst as "the 1993 Corporate Hotelier of the World" for his understanding of the hotel industry, his keen eye to study business deals, his financial prowess and a dual commitment to employee well being and guest satisfaction.

As a financial manager Hirst and his division have been a top performer of Hilton International's parent company, Ladbroke Group, a London-based company which acquired Hilton International in 1987. Hirst endured events beyond his control, including the Gulf War, wild fluctuations in world currencies, an economic recession in Europe and other parts of the world, an earthquake in Guam and the bombing of the World Trade Center in New York City, which was close to Hilton's Vista Hotel. While dealing with these events, Hirst was also planning future growth and extending Hilton International global reach, which is expected to include a portfolio of 200 hotels and resorts by the end of the decade. At the same time, Hilton International has been a leader in the use of technology, in motivating managers and assessing staff, and, most importantly, in developing innovative programs to meet specific needs of international travelers.

The Trusthouse Forte formula for success includes three Ps: people, product, and profits. Managers must be people oriented (customers and staff), product oriented (a quality product), and profit oriented (measurement of results).

Conclusion

As a result of the challenges facing the hospitality industry in the United States and abroad, to achieve financial success individual firms must develop a market niche, keep close contact with customers and shareholders, and redefine and focus on an unique mission as well as exploit new opportunities.

All companies included in this article owed their success not only to the managerial concepts and procedures, but also to their implementation. Some important lessons to be learned from these successful firms are as follows:

- diversification of product line while properly addressing consumer needs and adapting to a new marketplace
- emphasis on people, product, and profits
- proactive style of management in dealing with new industry developments
- maintenance of market share in the midst of challenging economic conditions
- maintenance of reputation for operating consistency

- development of creative financial maneuvers (recapitalization by Holiday Corp., spin offs by Marriott)
- innovation by developing unique concepts and utilizing managerial skills
- recognition that the most important financial goal is to maximize shareholders' value.

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