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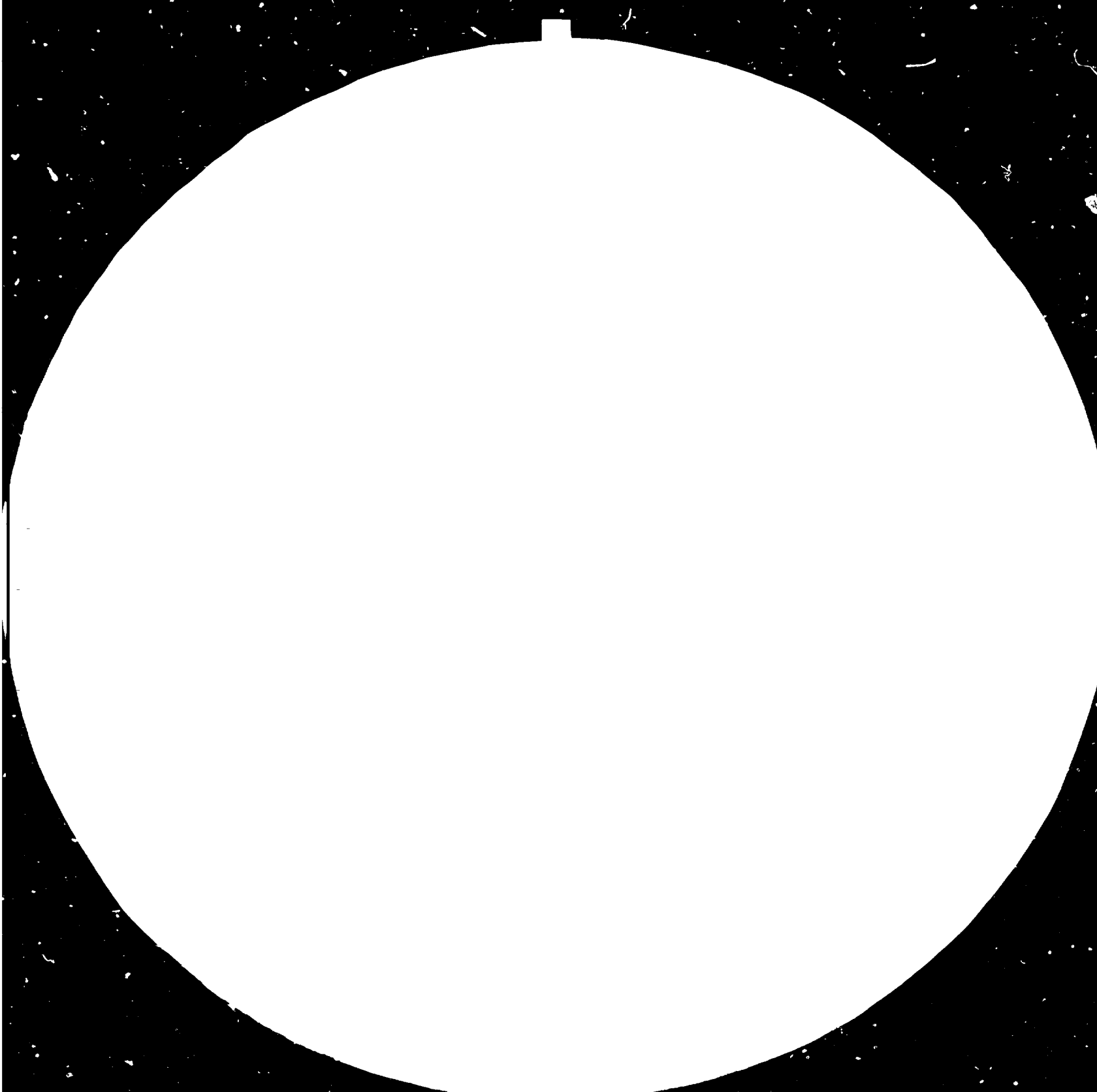
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12832



United Nations Industrial Development Organization

Distr.
LIMITED

ID/WG.405/1
7 September 1983
ENGLISH

Eighth Meeting of Heads of Technology
Transfer Registries
Caracas, Venezuela, 17-20 October 1983

CONTRACTUAL ARRANGEMENT FOR THE
TRANSFER OF TECHNOLOGY IN THE
HOTEL INDUSTRY *

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SUMMARY	CONTENTS	PAGE
INTRODUCTION		1
I. TRENDS IN DEVELOPMENT OF TRANSNATIONAL-ASSOCIATED HOTEL INDUSTRY IN DEVELOPING COUNTRIES		2
1. General trends		2
2. Major international hotel chains operating in developing countries		3
3. Scope and directions of expansion		5
4. The market shares of transnational hotel chains in developing countries		7
5. Transnational hotel chains and technical co-operation among developing countries (TCDC)		7
II. MAJOR POLICY OPTIONS FOR DEVELOPING COUNTRIES WITH REGARD TO THE SCOPE AND FORMS OF FOREIGN PARTICIPATION IN THE HOTEL INDUSTRY		9
1. Contractual arrangements used in the international hotel industry		9
2. Major policy options		13
III. MANAGEMENT CONTRACT		18
1. Introductory remarks		18
2. Pre-opening services		18
3. Managerial services provided at the operational stage		20
4. Group services		22
5. Use of trade names		23
6. Forms of remuneration of the foreign partner		23
7. Other matters related to payments		31
8. Duration and extension of the agreement		33
9. Preferential right of purchase		35
10. Applicable Law		35
IV. FRANCHISE AGREEMENT		36
1. Introductory remarks		36
2. Services offered by the Franchisor		36
3. Remuneration for the services provided by the Franchisor		39
4. Other matters related to payments		40
5. Duration and extension of the agreement		40
6. Preferential option to management and lease		41
7. Applicable law		41
CONCLUSIONS AND RECOMMENDATIONS		42
Annex I. Outline of a typical management contract		44
Annex II. Outline of the franchise agreement		46

SUMMARY

During recent years a rapid development of international tourism to developing countries has taken place which has led to the expansion of transnational hotel chains. Towards the end of the 1970s, there were 16 transnational hotel chains with 8 or more associated hotels in developing countries.

The inflow of technology in this sector is being accomplished principally through non-equity arrangements. Among such arrangements the management contracts play a dominant role. Except for arrangements in a "pure" form, there are a variety of combinations widely used in the hotel industry. This seems to be of advantage for developing countries as it allows them a choice taking into account the availability of local skills and resources.

With respect to the foreign participation (equity and non-equity) in the hotel industry, it is recommended that developing countries follow a flexible attitude towards such participation, weighing positive and negative aspects of various options in each individual case. Non-equity forms of foreign participation should be definitely preferred. The popularity of management contracts reflects the present stage of development of an outward-looking hotel industry in developing countries. However, ad-hoc technical assistance and franchise agreements may gain importance in the future whereas the role of leasing may diminish and such arrangements should be avoided by developing countries. Therefore, the contractual arrangements used in the hotel industry should be subject to scrutiny by technology registries in the respective developing countries.

The contractual provisions in the management contracts and franchise agreements are usually drafted in such a way as to protect the interest of the foreign partner and not the Owner. Thus, the obligations of the foreign partner are stipulated in general terms unlike the obligations of the Owner, in which case strict formulations are usually applied.

The variety of forms of remuneration used in management contracts is detrimental to the Owner which it makes difficult to evaluate and control the execution of the agreement with respect to the equitable sharing of profits between the Management Company and the Owner. It often happens that the revenues and profits which are satisfactory for the Manager are far behind that which would be required for ensuring an adequate return on the Owner's investment. Therefore, the provisions safeguarding minimum payments for the Owner are of crucial importance. It is recommended that guidelines for the payments evaluation in the service agreements in the hotel industry should be elaborated along the lines of those already applied in the manufacturing sector.

Bearing in mind the future development of the outward-looking hotel industry in developing countries and the projected growth of the number of contractual arrangements covering the transfer of technology in this industry, it is recommended that the activities of UNIDO in that field, through TIES, should be continued. The effectiveness of the work of UNIDO might be substantially increased by the active participation of the member countries and by establishing close contacts with other international organizations i.e. United Nations Centre on Transnational Corporations and the World Tourism Organizations.

INTRODUCTION

Since the mid-1960s a rapid development of international tourism to developing countries has been observed. During the 1965-1976 period tourism arrivals in developing countries increased by 12 per cent per annum as compared with 5 per cent per annum in the case of arrivals in developed countries.^{1/} In connection with the development of tourism, the expansion of international hotel operations took place, mostly in the form of transnational hotel chains.

The inflow of technology necessary for setting up and operating hotels for international tourism in developing countries has been accomplished principally through non-equity arrangements. Although these arrangements are gaining importance in the activities of transnational corporations in various sectors,^{2/} they play a dominant role in the hotel industry and equity participation is relatively limited.

In view of the above, it is important to study various aspects of contractual arrangements used in the transfer of technology in the hotel industry in developing countries. During the Seventh Meeting of Heads of Technology Transfer Registries, held in December 1982 in New Delhi, the UNIDO secretariat was requested to "undertake and present, as soon as possible, the study and guidelines on treatment and evaluation of franchise agreements of various types, specifically in fast-food chains, hotels and similar industries".^{3/}

In connection with the above recommendation, the UNIDO secretariat requested several countries who are members of the Technological Information Exchange System (TIES), to provide background information on the subject, and specifically

^{1/} "Transnational Corporations in International Tourism", Centre on Transnational Corporations, ST/CTC/18, United Nations, New York, 1982, p.1.

^{2/} See "Transnational Corporations in World Development. Third Survey", Centre on Transnational Corporations, ST/CTC/46, United Nations, New York, 1983, pp. 40-46.

^{3/} Report of the Seventh Meeting of Heads of Technology Transfer Registries, New Delhi, 7-10 December 1982, UNIDO, ID/WG.383/8, para 3(j).

to provide the sample copies of management and franchise agreements used in the hotel industry. At present, this information has been collected from Argentina, Colombia, Egypt and Malaysia.

Since the issue of technology transfer in the hotel industry is a relatively new one, the present study is of a preliminary character. It attempts to provide a general picture of contractual arrangements used in technology transfer in the hotel industry, with special reference to management contracts and franchise agreements which are most popular in the case of foreign-associated hotels in developing countries. It is expected that further discussions and exchange of experience among respective government agencies may result in the elaboration of detailed policies and guidelines with respect to technology transfer in this sector.

In the preparation of this paper, extensive use has been made of the work carried out by the United Nations Centre on Transnational Corporations and the World Tourism Organization.^{4/}

CHAPTER I

I. TRENDS IN DEVELOPMENT OF TRANSNATIONAL-ASSOCIATED HOTEL INDUSTRY IN DEVELOPING COUNTRIES

1. General trends

The expansion of international tourism has resulted in the extension of the operations of domestic hotel chains in foreign countries. According to a recent survey conducted by the United Nations Centre on Transnational Corporations in 1978, there were 81 hotel companies associated with two or more hotels abroad.^{5/} Altogether, these companies were associated with 1,025 foreign hotels. The concept of "association" with respect to the international hotel

^{4/} This applied especially to Chapter I where main results of the studies done by the UNCTC and WTO are summarized. See UNCTC "Transnational Corporations in International Tourism", op. cit. and WTO, "Accommodation Management Methods: The Management Contract", PG(II)1. 3.2.B/1, Madrid 1980.

^{5/} See "Transnational Corporations in International Tourism", op. cit., p. 7-30.

industry requires further clarification. Unlike other industries, where direct or portfolio investments dominated in the various forms of foreign involvement, in the hotel industry the non-equity forms of foreign participation were most often used.^{6/} Thus the term "associated" embraces both equity and non-equity arrangements.

The international hotel chains originated mostly from the United States (22), United Kingdom (13), France (8) and Japan (7). Of a total of 1,025 foreign-associated hotels, 486 i.e. 47.5 per cent of the total, were located in developing countries. Thus, the international hotel industry is much more oriented towards developing countries as compared, for example, to the manufacturing sector where developing countries accounted for 21.8 per cent of the net inflows of direct foreign investment during 1970-1980.^{7/}

2. Major international hotel chains operating in developing countries

Among 81 transnational hotel chains there are 16 chains with 8 or more associated hotels in developing countries. They account for almost 70 per cent of all foreign-associated hotels in these countries (see Table 1). The domination of the US-based hotel chains is clearly visible but the strong position of French international chains, being the result of their expansion in French-speaking Africa, is worth noting. Among leading hotel chains there is one - Oberoi Hotels, originating from a developing country, namely India.^{8/}

The foreign propensity ratio (number of foreign hotels as a percentage of the total number of associated hotels) ranges from 7.8 per cent (Holiday Inns)

^{6/} These various arrangements will be discussed later.

^{7/} "Transnational Corporations in World Development. Third Survey", op. cit. Annex, Table 11.2, p. 286.

^{8/} Among 81 hotel companies with two or more associated hotels abroad there are in addition to Oberoi, 8 other chains originating from developing countries. Of these there are 4 chains based in Hong Kong (3 of them managed by nationals from developed countries) with 14 foreign hotels, one from Colombia (4 foreign hotels), one from Mexico (3) and one from Saudi Arabia (2).

Table 1

Major transnational hotel chains operating in developing countries, 1978

Name	Parent Country	Number of associated hotels in developing countries	Foreign propensity ratios	
			foreign hotels as % of the total number	hotels in LDC's as % of foreign hotels
1. Holiday Inns	USA	47	7.8	41.2
2. Intercontinental	USA	46	97.4	62.2
3. Hilton International	USA	39	98.6	54.2
4. Sheraton Hotels	USA	30	15.9	46.9
5. Club Méditerranée	France	26	57.1	46.4
6. PIM Hotels	France	22	54.6	91.7
7. Hyatt International	USA	20	100.0	76.9
8. Novotel	France	18	27.8	40.0
9. Trust Houses Forte	UK	16	20.1	30.2
10. Western International	USA	13	55.3	50.0
11. UTH	France	13	100.0	100.0
12. Southern Pacific Hotel Corporation	Australia	10	41.0	40.0
13. Méridien	France	10	73.3	90.0
14. Oberoi Hotels	India	10	50.0	100.0
15. Ramada Inns	USA	8	5.1	24.2
16. Canadian Pacific	Canada	8	34.5	80.0
Total above		336	19.1	51.2

Source: Calculations based on "Transnational Corporations in International Tourism", op. cit., Table 3, p. 10.

to more than 97.0 per cent (Intercontinental, Hilton International, Hyatt International, and UTH). It should be pointed out that the strong foreign propensity of some leading hotel chains results from their expansion in developing countries. The UTH, Hyatt International, Méridien, PIM Hotels, Oberoi, Intercontinental and Hilton International are good examples in that respect.

3. Scope and directions of expansion

The geographical distribution of transnational-associated hotels in developing countries is shown in Table 2. Over 40 per cent of hotels are located in Latin America, the Caribbean and the Western Atlantic Islands. In addition, 11 developing countries account for 35 per cent of the total number of transnational-associated hotels. Geographical directions of expansion differ substantially among international hotel chains which can be explained by variety of factors. First, the geographical proximity may, in part, explain the concentration of Japanese-based chains in Asia, Australian chains in Oceania, and US-based chains in Asia, Latin America and the Caribbean. Secondly, former colonial relationships also play an important role, especially in the case of French chains in French-speaking African countries. Thirdly, some chains are specialized in accommodating business travellers, whereas others are more oriented towards sun-seeking tourists. As a result, in the case of chains representing the first group, the Intercontinental and Hilton International cater especially for business travellers and have only one sixth of the number of associated foreign hotels in resort areas as compared to four fifths of the Club Méditerranée and three fifths of Trust Houses Forte Group.^{9/}

The expansion of the foreign-associated hotel industry in developing countries is a recent phenomenon and gained momentum in the mid-60s. In the 70s, a rapid increase of the number of foreign-associated hotels (including those under construction) took place in the business centres of the Middle East, North Africa (Egypt) and South-East Asia. On the other hand, the share of Latin America, Caribbean and Oceania showed a decreasing trend.

^{9/} "Transnational Corporations in International Tourism", op. cit. p. 16.

Table 2

Geographical distribution of transnational-associated hotels in developing countries,
1978

<u>Regions and countries</u>	<u>Number of hotels</u>	<u>% of the total number of transnational-associated hotels in developing countries</u>
<u>Africa (26)^{a/}</u>	<u>104</u>	<u>21.4</u>
Morocco	20	4.1
<u>Asia (14)</u>	<u>86</u>	<u>17.7</u>
Philippines	14	2.9
Indonesia	14	2.9
Singapore	9	1.9
Hong Kong	6	1.2
<u>Latin America (16)</u>	<u>101</u>	<u>20.8</u>
Mexico	39	8.0
Venezuela	16	3.3
Brazil	13	2.7
<u>Caribbean and Western Atlantic Islands (16)</u>	<u>99</u>	<u>20.4</u>
Puerto Rico	14	2.9
Bahamas	13	2.7
<u>Middle East (13)</u>	<u>63</u>	<u>13.0</u>
<u>Oceania (8)</u>	<u>33</u>	<u>6.8</u>
<u>Total developing countries (93)</u>	<u>486</u>	<u>100.0</u>

a/ In brackets total number of countries is given in which transnational-associated hotels operate.

Source: Calculations based on "Transnational Corporations in International Tourism", op. cit., Table 6 and 9, pp. 17, 21.

4. The market shares of transnational hotel chains in developing countries

Transnational-associated hotels accounted for 11.1 per cent of the total number of hotel rooms in 1978 which is a much higher share than that of the developed countries (see Table 3). The situation, however, is quite diversified among the developing countries themselves. In the case of Bermuda, French Polynesia, Gabon, Ivory Coast, Madagascar, Martinique, New Caledonia, Philippines, Puerto Rico, Saint Lucia, Senegal, Seychelles, Trinidad and Tobago, the share of foreign-associated hotels exceeded 40 per cent. The data in Table 3 revealed relatively small market shares of international chains in larger developing countries having a well established local hotel industry. An attractive climate also plays an important role, but in view of the prevailing tendency of international chains towards servicing business travellers, this seems to have become less important in recent years. Bearing in mind that foreign-associated hotels are usually of the luxury class, (three-star or above) their market shares are much higher in these categories, e.g. Egypt 41.2 per cent, Tunisia 20.7 per cent and Philippines 57.1 per cent.

5. Transnational hotel chains and technical co-operation among developing countries (TCDC)

Until now, foreign participation in the hotel industry in developing countries has been analyzed within the framework of North-South relations. However, there are strong arguments for the future expansion of LDC-based international hotel chains. First, in the case of luxury hotels oriented towards attracting foreign visitors, there are substantial economics of scale associated with international chains (marketing, reservation system, training, joint purchasing, etc.). Second, in many developing countries sizeable domestic hotel chains already operate, e.g. El Presidente (Mexico), National Hotels (India), Othon Hotels (Brazil), Merlin Hotels (Malaysia) and Nigeria Hotels (Nigeria). Third, the internationalization of LDC-based hotel chains has already started ^{10/} and the example of the Oberoi Hotels (India) shows that effective competition with well established hotel chains might be possible even in developed countries. The idea of establishing regional hotel chains in developing countries seems to be most attractive and should be considered as an important aspect of regional co-operation among developing countries.

^{10/} See page 3.

Table 3

Share of foreign-associated hotel rooms from total hotel rooms in developing countries (percentage)

Developing countries and territories	Share	Developing countries and territories	Share
<u>Africa</u>		<u>Caribbean etc.</u>	
Gabon	53.8 <u>a/</u>	Antigua	32.2
Ghana	...	Bahamas	35.6 <u>a/</u>
Ivory Coast	41.7 <u>a/</u>	Barbados	14.9
Kenya	13.1	Bermuda	46.7
Lesotho	28.0	Cayman Islands	...
Madagascar	46.1	Dominican Republic	30.5 <u>a/</u>
Mauritius	4.9	Jamaica	31.0 <u>a/</u>
Morocco	16.6 <u>a/</u>	Martinique	67.2 <u>a/</u>
Senegal	49.7	Puerto Rico	43.4 <u>a/</u>
Seychelles	61.0 <u>a/</u>	Saint Lucia	43.8 <u>a/</u>
Tunisia	9.4	Trinidad and Tobago	42.6 <u>a/</u>
United Rep. of Cameroon	10.9 <u>a/</u>		<u>35.6</u>
Zambia	39.2		
	<u>17.7</u>		
<u>Asia</u>		<u>Middle East</u>	
Afghanistan	11.1 <u>a/</u>	Egypt	28.5
Bangladesh	6.2 <u>a/</u>	Iran	20.7 <u>a/</u>
Hong Kong	34.0	Israel	15.7
India	10.2	Jordan	33.0 <u>a/</u>
Indonesia	10.6 <u>a/</u>	Lebanon	30.7 <u>a/</u>
Malaysia	5.6	Syrian Arab Republic	7.4
Pakistan	10.0	Turkey	9.2 <u>a/</u>
Philippines	43.9		<u>16.0</u>
Republic of Korea	27.5		
Singapore	32.6		
Sri Lanka	21.3		
Thailand	10.4		
	<u>16.6</u>		
<u>Latin America</u>		<u>Oceania</u>	
Argentina	12.1	Cook Islands	15.2
Brazil	1.8	Fiji Islands	27.7
Chile	4.5	New Caledonia	44.6
Colombia	16.1	Tahiti (French Polynesia)	45.8
Ecuador	2.8 <u>a/</u>		<u>28.7</u>
Guatemala	13.8		
Mexico	5.6 <u>a/</u>		
Panama	25.5 <u>a/</u>		
Peru	2.8 <u>a/</u>		
Venezuela	33.4		
	<u>4.6</u>		
All developing countries	11.1		
All developed countries	2.1		
All countries	3.3		

a/ 1976 or 1977 data

Source: "Transnational Corporations in International Tourism", op. cit., Table 9, p.21.

II. MAJOR POLICY OPTIONS FOR DEVELOPING COUNTRIES WITH REGARD TO THE SCOPE AND FORMS OF FOREIGN PARTICIPATION IN THE HOTEL INDUSTRY

The policy options of respective developing countries with regard to the various contractual arrangements have to be evaluated within a broader policy framework for development of the hotel industry in developing countries. Such policy depends in turn on the specific conditions prevailing in a given country: climat and geographical conditions, level of economic development in general and the hotel industry in particular, availability of local skills and resources, priorities with regard to foreign tourism, marketing conditions etc. We shall briefly discuss major policy options in that field while limiting the analysis to the foreign-oriented hotel industry only.

1. Contractual arrangements used in the international hotel industry

a) General trends

The following contractual arrangements are mostly used between transnational hotel chains and partners in developing countries:

- i. equity ownership ensuring management control;
- ii. management contracts, including ad-hoc technical assistance agreements;
- iii. leasing arrangements;
- iv. franchise agreements.

As has already been indicated, equity ownership does not play an important role in the hotel industry in developing countries and in such cases the foreign partner has usually a minority interest only. In fact, the share of arrangements with foreign equity participation has drastically fallen after 1975 (see Table 4). The same applies to leasing arrangements and to some extent to franchise agreements. The management contracts on the other hand are gaining importance. According to UNCTC estimates management contracts as a form of foreign involvement account for 72 per cent of rooms in transnational-associated hotels in Africa, 60 per cent in Asia, 47 per cent in Latin America and 75 per cent in the Middle East.^{11/}

^{11/} "Transnational Corporations in International Tourism", op. cit. p.28.

Table 4

Transnational-associated hotels in developing countries: breakdown by type and date of involvement, 1978
(Percentage of hotel rooms)

Period	Ownership (or part ownership)a/	Leasing arrangements	Management contracts b/	Franchising	Total
Before 1964	21.8	45.0	33.2		100.0
1965-1974	22.2	22.0	56.8		100.0
1975 and after	6.7	2.7	90.6		100.0
All periods	17.6	10.3	63.1	9.0	100.0

a/ Where accompanied by some operating participation

b/ Including ad-hoc technical assistance agreements

Source: "Transnational Corporations in International Tourism"
op. cit. Table 12, p. 26.

b) Brief description of non-equity arrangements ^{12/}

i. Leasing arrangements

There are several forms of leasing agreements. In general terms such contracts stipulate a minimum rent payable to the Owner expressed as a percentage of the capital cost of the hotel, plus a percentage of the gross operating profits of the hotel. Usually the tenant pays to the Owner between sixty and eighty per cent of the hotel profits after deduction of expenses connected with the operation of the hotel over and above the minimum rent payable to the Owner. Any losses are carried by the tenant who manages the hotel and provides marketing services under his trademark. In the latter case, on the average 2 to 3 per cent are normally deducted from the turnover of the hotel. The duration of the leasing contracts is usually for the period of twenty years.

ii. Management contract

A management contract is an agency agreement between a management company (transnational hotel chain) and the property Owner, whereby the management company assumes complete management responsibility for the hotel. For this service, the management company is paid a fee based on a prescribed formula.

The Owner occupies a passive position in terms of operational policies, procedures and day-to-day management. He is however financially responsible for the property and must replenish operating capital in the event of a negative cash flow. The principal difference between management contract and a lease is that under a management contract the residual income (or loss) accrues to the owner whereas under a lease it goes to the tenant.

Under the management contract transnational hotel chains provide operating services including the administration and supervision of day-to-day business, strategic and technical planning and implementation of management decisions. In addition, the marketing, sales and reservations support systems and services are also provided.

^{12/} This section is based on WTO "Accommodation Management Methods: The Management Contract", op. cit., pp. 3-8.

The management contracts are usually for a period of between 10 and 20 years with possible renewal for a further period on the same terms and conditions.

iii. Franchise agreement

Under franchise agreement the Owner (franchisee) is allowed, for a fee, to use the name, trademarks and various services offered by the franchisor (transnational hotel chain). The fee usually comprises a fixed sum plus a percentage commission on rooms. The set of services provided by the franchisor includes worldwide communications and reservation system, brands advertising supervision and enforcement. Transnational chains usually also provide information manuals, sales and promotion aids, employee training films and information about new operating techniques. The Owner, on the other hand, is required to work according to the systems established for the whole chain and to meet its standards.

The franchise agreements are normally for 10 to 20 years.

iv. Differences, similarities and inter-relationships between various contractual arrangements

While comparing various contractual arrangements used in the hotel industry, two additional aspects have to be taken into account. First, except for arrangements in a "pure" form, there is variety of combinations widely used in the hotel industry, e.g.:

- management, franchise or leasing agreements are often combined with small equity interests of the foreign partner;
- management contracts are signed with a local management company, which in turn is controlled by a transnational hotel chain;
- the franchise agreements often involve some participation in the management operations where the franchisor designates the manager.

On the other hand, various types of agreements which are concluded by developing countries are usually signed with large transnational chains. As a result various contractual "packages" contain common elements, e.g. under the management contract the foreign partner provides management services plus all services covered under the franchise agreement.^{13/} Therefore various contractual arrangements might be ordered according to the decreasing involvement of the foreign partner. This is illustrated in Table 5.

In view of the above, the following observations can be made with respect to the negotiating position of the local partners in developing countries. First, the variety of contractual arrangements used in the hotel industry seems to be of advantage for developing countries as it allows them a choice of the most suitable arrangements, taking into account the availability of local skills and resources. As the position of the local partner may improve under the duration of the contract (e.g. management services may not be needed after training of local staff) it is important for the local partner to be safeguarded through provisions which permit a smooth transfer to another arrangement with a lower involvement of the foreign partner. For example, the local partner may be granted the option, after expiration of the initial term of the management contract, to sign franchise agreement with the same foreign partner.

2. Major policy options

a. Foreign participation versus reliability on local skills and resources.

In the modern hotel industry especially in high-class, luxury hotels for foreign tourists, sophisticated technological, managerial and marketing skills are required. However, these skills and technologies are not as complex and specialized as in the modern manufacturing sector. Therefore, unlike high-technology manufacturing industries, developing countries may in principle follow an independent route for the development of their hotel industry.

^{13/} The names of the contractual arrangements might also be confusing. Sometimes management contracts are named as service agreements and franchise agreements often bear the official title "licence agreement".

Table 5

The forms of foreign involvement in various contractual arrangements used by transnational hotel chains

Type of contractual arrangements	Types of services and/or resources provided by the foreign party			
	Equity investment	Management services	Group services	Trademarks
1. Wholly or majority-owned subsidiary	X	X	X	X
2. Leasing agreement with minority equity participation	P ^{a/} X	X	X	X
3. Pure leasing agreement		X	X	X
4. Management contract with minority equity participation <u>b/</u>	P X	X	X	X
5. Pure management contract		X	X	X
6. Franchise agreement with minority equity participation	P X		X	X
7. Franchise agreement with the manager designated by the franchisor		P X	X	X
8. Pure franchise agreement			X	X

a/ P - partial involvement.

b/ Another version is the foreign equity participation in the management company set-up in the host country exclusively for managing the hotel.

Source: Survey conducted by the UNIDO secretariat in 1983.

Two factors have to be taken into consideration while evaluating the need for foreign participation. First, dependence on foreign skills and technologies is quite strong at the early stages of development of the hotel industry so that the independent pattern for installing their modern accommodation for foreign visitors might be chosen by countries where their local industry has reached a certain degree of skill. Second, economies of scale associated with international chain operators, especially in the area of advertising, computerized reservation system, centralized training programmes, etc. should also be taken into account. It is therefore recommended, that developing countries follow a flexible attitude towards foreign participation in the hotel industry, weighing both the positive and negative aspects of various options in each individual case.

b. Equity participation versus non-equity arrangements

Unlike the manufacturing sector, technologies and skills in the hotel industry are not tied to foreign equity ownership. Expertise in the construction and day-to-day management of modern hotels as well as finance capital can easily be obtained on international market from sources other than transnational hotel chains (e.g. from consulting firms and financial consortia specialized in that field). Experience shows that transnational hotel chains do not, as a rule, insist on equity interests in developing countries, and this form of foreign involvement in the hotel industry definitely shows a decreasing trend. In view of the above, the non-equity arrangements should be preferred by developing countries over direct foreign investment. However, minority interest combined with management or franchise agreements might also be viewed as an alternative solution, since this may provide additional incentive for more efficient management and/or render group services by the foreign company. ^{14/}

c. Setting priorities with regard to non-equity arrangements used in the hotel industry

As has been indicated in the previous section, there is a substantial variety of contractual arrangements used in the international hotel industry. This enables

^{14/} The survey conducted in the Caribbean has shown that satisfactory operations of transnational hotel chains were usually connected with some financial involvement. See "Transnationals and Tourism in the Caribbean", P. Chen-Young and Associates, Commonwealth Secretariat, London, 1977, p. 75.

the choice of not only a certain type of arrangement but also its variation that would be most suitable in a given country with respect to the level of development of the local hotel industry and the availability of skills and resources. Bearing in mind the passive role of the owner and the total lack of control of hotel operations in the case of leasing agreements, it is recommended that such arrangements be avoided by developing countries and the data presented earlier has indicated that this has already taken place. On the other hand, the experience of several developing countries shows that at the early stages of development the establishment of modern hotels aimed at attracting foreign visitors may require substantial foreign involvement in the form of management contracts. In other words, the popularity of management contracts reflects the present stage of development of the foreign-oriented tourist industry in developing countries. With the steady accumulation of experience and skills of local personnel it might be expected that the foreign content in the whole "package" will gradually decrease, especially in the more advanced countries. In terms of contractual arrangements used in the hotel industry, the ad-hoc technical assistance and franchise agreements will probably gain importance in the future.

d. Registration and approval of contractual arrangements used in the hotel industry

The following discussion will be limited to management and franchise agreements as these arrangements are most often used in developing countries. There are strong arguments that such contracts should be the subject of scrutiny by technology registries in developing countries:

1. such agreements as a rule cover the flow of information, managerial, technical and marketing expertise which is vital for the future development of the outward-looking hotel industry in developing countries;

ii. in a number of developing countries great attention is being paid to the construction of first-class hotels aimed at attracting wealthier foreign visitors. Consequently, the share of the hotel industry in total technology inflows into these countries may substantially increase in the near future;

iii. the management and franchise contracts result in the payments to the foreign partner which usually have to be transmitted abroad. With the growing number of such agreements signed in developing countries this may create substantial burden on the balance of payments offset against tourism income. On the other hand, the system of approval of foreign payments commonly used in developing countries can be applied for effective control of the franchise and management contracts;

iv. as the analysis in Chapters III and IV indicate the problems arising from the negotiations of franchise and especially management agreements are quite complex, whereas the understanding of these issues by the average local entrepreneur in the hotel industry is quite limited.

At the moment the situation with respect to the registering of franchise and management agreements is quite varied. In general, the existing laws do not specifically list franchise and management contracts, with these agreements usually falling under broad definitions of technology transfer agreements and subject to registration and approval. In practice much depends on present experience and the specific regulations issued by the individual registries in developing countries.

III. MANAGEMENT CONTRACT

1. Introductory remarks

The conclusions and draft guidelines presented in this section are based on the survey of seven management contracts concluded by major transnational chains with three developing countries.

The analysis revealed that the management contracts differ in terms of size and structure, but all of them contained basic provisions. The search for standardized contracts used by transnational chains in different developing countries brought mixed results. On the one hand, our sample contained two management contracts concluded by one large transnational hotel chain with partners in two developing countries and revealed that some provisions were similar, whereas the structure and phrasing of elements of contracts differed considerably. On the other hand, one contract signed with another transnational chain (Hilton International) showed a strong resemblance to the example of a typical management contract reproduced in the WTO study. Although it seems that a "standard format" of the management agreement in the hotel industry does not exist, the Hilton International management agreement is definitely a typical one. The outline of this contract is reproduced in Annex 1. The most essential and controversial provisions of the management contracts are evaluated from the point of view of the hotel Owner,^{15/} together with suggestions on the possible approaches by the respective government agencies.

2. Pre-opening services

The most important issues to be taken into account with regard to pre-opening services are related to the scope of such services available from the Management Company, whether they are obligatory or not, and to what extent the Management Company exercises control upon the services provided by third parties. This in turn, affects the resolution of payments for the pre-opening programme which will be discussed later.

^{15/} For the description of the parties of the management agreement we consequently use the terms Owner and Management Company (MC).

The pre-opening services usually cover the use of experience and expertise of the staff of the Management Company in the areas of interior design, kitchens and laundry, layout and equipment, graphic and design services, hiring and training of initial personnel, promotional activities, etc.

In most cases, the respective contract provisions give the Management Company considerable freedom in conducting the pre-opening programme within the budget approved by the Owner. Two contracts (B and G) contained provisions on the employment of the hotel's essential staff prior to opening of the hotel (Hotel Manager, Food and Drinks Manager, Marketing Manager, Chief Cashier, Chief Engineer, etc.). Although it is not stipulated precisely, it could be understood that such provisions enable the Management Company to employ its expatriate staff for top positions at the pre-opening stage.

In one case (Contract B) pre-opening services are combined with authorisation and supervision of the services provided by the third parties:

"Subject to the prior written approval by MC, Owner agrees to engage and retain, at its expense, a firm or firms of architects and such engineers, designers, decorators, landscape architects and other specialists and consultants as shall be necessary and appropriate. Owner agrees to cause such firms and person to prepare full and adequate plans, layouts, specifications, drawings and designs, both interior and exterior, with respect to the Site, the Building, Furnishings, and Equipment, such other matters as may be required. MC agrees to provide full assistance and consultancy services to the Owner or its architects, engineers, contractors, designers and others on plans, specifications and designs to complete the Hotel to MC standard for the Specialised Hotel Equipment and Operating Equipment.

All such plans, layouts, specifications, drawings, designs, decor and concept themes and any changes in, or departures therefrom, subsequently made or authorized, shall be subject to the final mutual approval in writing of Owner and MC."

More typical however, are general provisions for final approval of the overall conditions of the hotel by the Management Company prior to the opening which may be conducted in the form of pre-opening inspection, e.g. Contract G:

"An inspection will be made by MC prior to the opening, and

the Owner agrees to take all the measures necessary to make good any deficiency noted in this inspection so that the Hotel can meet the construction and operating standards of MC. If MC should so wish, it may accept the Hotel on condition that the Owner makes good any deficiency."

It might be concluded that the contractual provisions with respect to pre-opening services would require more precise formulation because in the form as it was found in the agreements studied the obligations of the Management Company are stipulated in general terms unlike the obligations of the Owner, in which case strict formulations are usually applied.

3. Managerial services provided at the operational stage

The contractual arrangements studied differ substantially as to the definition of managerial services provided by the Management Company. In some cases the agreements refer simply to the international management standards in the hotel industry, e.g. Contract A:

"MC covenants to use the Hotel solely for the operation of a first-class hotel and for all activities in connection therewith which are customary and usual to such an operation, and, insofar as shall be feasible, shall conduct such operations so as to accord with the character and traditions of the Country."

The alternative way of the general definition of the scope of management services is to refer to the international standards applied worldwide by a given transnational chain, e.g. Contract B:

"MC shall operate the Hotel as a 'MC' Hotel at the expense of Owner in accordance with the provisions of the Agreement hereinafter appearing and in accordance with MC international standards. MC shall operate the Hotel to the extent economically and legally possible in accordance with the same procedures, practices, management techniques and other Rules of Operation used by MC in the operation of other 'MC' Hotels, the right of revision and amendment of such being reserved by MC."

In some contracts a more elaborated list of Manager's duties is provided or a general definition is supplemented by the specific provisions in some crucial areas (Contract D, E, F).

One of the most crucial aspects in that field is the specification of the Owner's rights to interfere in the day-to-day operation of the hotel. The majority of contracts contain respective provisions declaring the exclusive right to control current operations by the Management Company and non-interference on the part of the Owner. The Contract A may serve as an extreme example of such case:

"It is understood that MC shall have within the terms and provisions hereof absolute control and discretion in the operation of the Hotel and shall retain throughout the term of this agreement and subject to its terms, control and management, in its own name, of all properties and funds relating to the operation. The right of the Owner to receive financial returns from the operation of the Hotel, subject to the fee to be retained by MC, shall not be deemed to give the Owner any interest, control or discretion in the operation of the Hotel. Without limiting the generality of the foregoing, such control of and discretion by MC shall include and extend to, among other, the use of the Hotel for all customary purposes, the charges to be made for and the terms of admittance to the Hotel for rooms, for commercial space, for privileges for entertainment and amusement, for food and beverages, and the labour policies of the Hotel (including wage rates, and the hire and discharge of employees), and all phases of promotion and publicity."

The hiring of top executive personnel is one of the key rights exercised by the Owner and the Management Company. Among the contracts studied three situations were distinguished:

- within the scope of the agreement, the Management Company retains full control and discretion with respect to hiring and discharging of all employees in its own name (see Contract A quoted above);
- unlike other personnel, the key executive staff is employed directly by the Management Company and is on the Management Company's payroll (Contract A, B and G);
- all personnel is hired by the Management Company in the name of the Owner (Contract C and D);
- the selection of the General Management and other key personnel is listed under duties of the Management Company (Contract E);
- the General Manager of the Hotel shall be selected by the Management Company, his assignment shall, however, be subject to approval by the Owner (Contract F).

Thus, it might be argued that the Management Company usually retains exclusive control over the selection of key personnel in the hotel. Although this is definitely an essential element of a management function as such, in view of the importance of the General Manager for the success of the whole venture, some control of its selection as in the case of Contract F, should be executed by the Owner.

The rights of the Management Company to employ foreign staff should be viewed in connection with its overall rights to select personnel as described above. It is interesting that only in Contract F respective provisions refer directly to that issue. It is stated that:

"MC shall be entitled to engage foreign personnel, if such are not available among the citizens of X country, and MC undertakes to train suitable local personnel within shortest practicable time MC shall be entitled to employ and keep foreigners for the functions of General Manager and Assistant General Manager, if their employment is decreed by MC as necessary for the success of the Operation."

Taking into account the rights to engage directly the key personnel by the Management Company as in Contract A, B and G, the lack of respective provisions in the management contract gives, in fact, the Management Company a free hand with regard to the employment of foreign personnel. This is, in principle, against the development strategies followed by developing countries and again, Contract F may serve as an example of the positive solution for the above-mentioned problem.

4. Group services

The services which result from the international network of trans-national chain operations are considered as an important asset for a new hotel for foreign tourists, and therefore the proper specification of such services is of the utmost importance. Hereunder, the following approaches in the contracts studied might be distinguished:

- the group services and the readiness of the Management Company to render such services are clearly defined (Contract A and C), e.g.:

"MC shall provide or shall cause its affiliated companies to provide, in the operation of the Hotel and for the benefit of the guests thereof, inter-hotel reservation, credit card, central billing, convention and business promotion, sales promotion, publicity and

public relations, front office, food and beverage, personnel, and other operational departmental supervision and control and other group benefits, services, facilities and advertising furnished to other hotels owned or operated by MC and its affiliated companies (herein called Group Services), including reservation, billing and credit services.";

- group services are defined in more general terms and relate mostly to the marketing and promotional activities. This happens in the case of management contracts with smaller hotel chains, which do not have an independent reservation system (Contract D, E, F);
- in two management contracts signed with the same large transnational hotel chain (B and G) the universally applied fees are specified for the group services which are obligatory to each hotel in the chain. These include: MC reservation system, system-wide advertising service, reservation sales office service, and MC university;

Especially in the latter case the position of the Owner is rather weak, as he agreed to pay for the group services without specifying conditions for the effective use of such services.

5. Use of trade names

Except for one, all contracts contained specific provisions for the use of trade names of the Management Company. The approach applied is quite uniform. First, all contracts confirmed the exclusive ownership rights of all service marks, trademarks, trade names, etc. by the Management Company. Second, all six contracts included explicit provisions on the obligatory cease of the use of trade names by the Owner after expiration, or earlier termination, of the agreement. Such unified formulations in the contracts studied may suggest that with regard to the use of trademarks this became a standard practice in the transnational hotel industry.

6. Forms of remuneration of the foreign partner

The remuneration of the Management Company for its services is probably one of the most difficult issues in the management contracts in the hotel industry. As compared to the licensing agreements in the

manufacturing sector there is a much greater variety of forms of remuneration. Taking into account all payments which may result in the remittances in foreign currency, the following forms of remuneration might be distinguished:

- commitment fee;
- reimbursement of pre-opening expenses;
- remuneration of expatriate personnel directly engaged in the hotel operations;
- basic management fee;
- incentive fee;
- payments for the group services;
- payments for the use of trade names;

The management contracts surveyed differ substantially as to the incidence of the various forms of remuneration (see Table 6). These forms are discussed in detail below.

Table 6: The incidence of the various forms of remuneration for the services rendered by the Management Company

Forms of remuneration	Contract						
	A	B	C	D	E	F	G
1. Commitment fee		X					
2. Reimbursement of pre-opening expenses	X	X	X	X		X	X
3. Remuneration of the expatriate personnel	X	X	X	X	X	X	X
4. Basic management fee	X	X	X	X		X	X
5. Incentive fee		X	X	X	X	X	X
6. Payments for the group services	X	X	X	X	X	X	X
7. Payments for the use of trade names		X		X			X

Source: Survey conducted by the UNIDO Secretariat in 1983

a) Commitment fee

Such a form of remuneration was found in Contract B only:

"In consideration for the execution of this Agreement Owner agrees to pay to MC a commitment fee in the sum of X US dollars plus Y US dollars per guest rental room to be constructed in the Hotel. This fee which shall cover the technical services to be provided by MC (during construction stage) shall be paid prior to or at the execution of this Agreement and shall not be refundable once this contract has been executed."

It is difficult to justify the payment of the commitment fee according to the provision quoted above. If it is being done exclusively for the protection of the Management Company against on early withdrawal of the Owner from the agreement, similar safeguards should be included in order to protect the interest of the Owner. Remuneration for the technical services rendered during the process of building construction should not be accepted without detailed provisions regarding the scope of this services to be provided having been clarified and agreed upon.

b) Reimbursement of pre-opening expenses

As for the financing of the pre-opening expenses a significant uniformity has been found in the contracts studied. Except for Contract E where the hotel was already in full operation, it was clearly stated that such costs should be covered by the Owner. According to standard procedure, the Management Company prepares the budget of pre-opening expenses for the approval by the Owner. The expenses incurred by the Management Company should be reimbursed by the Owner but are subject to amortization usually over five years after the first year of the operation of the hotel.

Under such conditions, the Owner retains the control over pre-opening expenses mostly by approving the budget prepared by the Management Company.

At this stage however, the knowledge of the Owner of the possible costs of pre-opening activities is very limited, and he has to rely to a large degree on the experience of the Management Company. Therefore, it is advisable to include provisions as to

how the services provided by the Management Company should be calculated (preferably at cost, without any profits resulting from rendering such services). This may strengthen the position of the Owner in possible future disputes with regard of overcharging of such services.

c) Remuneration of the executive staff

The contractual provisions on the remuneration of executive staff should be considered in connection with provisions on the employment of expatriate personnel, as discussed earlier.

Among seven contracts studied, only one (Contract F) contained provisions and the upper limits of the salaries of the expatriate personnel:

"MC shall maintain salary and wage rates for personnel employed at the Hotel in line with, and not substantially higher than, salary and wage rates generally paid in the Hotel Industry in the country for personnel of similar experience and qualifications. No employee, other than the General Manager of the Hotel, shall be engaged for a salary greater than U.S.\$10,000. per year without Owner's approval. If the General Manager's salary is over U.S.\$15,000 per year, it will be subject to Owner's approval."

In other contracts, especially A, B, C, G the rights of the Management Company to determine the salaries of the executive staff are precisely stipulated together with bonuses and fringe benefits which accrue to the executive personnel at the Owner's expense.

The seven contracts studied included provisions on the remuneration of expenses resulting from the travel of Management Company staff, not directly employed in the Hotel but connected with its operation. In such cases the Manager is usually allowed to charge reasonable out-of-pocket expenses and provide free food and lodging at Hotel premises as operating cost. In one contract, (A) out-of-pocket expenses were limited to \$5,000 for fiscal year.

d) Basic management fee and incentive fee

These two fees are the most important forms of remuneration of the Management Company in the hotel industry. From the Owner's point of view both forms of remuneration have stimulating effects on the Management Company. The basic management fee calculated as a percentage of income (revenue) stimulates the increase of turnover (room occupancy, sales of food and beverages, etc.). This may result to a degree from the use of trade names and group services as well as the manager's marketing and promotional efforts. The incentive fee, on the other hand, which is calculated as a percentage of the gross operating profit depends on the effectiveness of the management operations (maximizing revenues while minimizing costs). Thus the combination of these two forms of remuneration would probably yield best results for the Owner who is interested in maximizing profits in the long run.

As can be seen from Table 7, except for Contracts B and G signed with the same large transnational chain, there is no clear trend as for the use, way of calculation and the level of basic management and incentive fees in the seven contracts surveyed.

e) Remuneration for group services and the use of trade names

The basic information on the incidence and forms of payment for the group services and the use of trade names is presented in Table 8. The following situations may be distinguished with respect to payments for the group services:

- respective provisions allow the Manager to charge the cost of group services to the operating expenses of the hotel on a "reasonable allocated basis" (Contract A,D,E,F);
- only out-of-pocket expenses connected with rendering group services are covered by the Owner (Contract C);
- fees for various group services are precisely defined and calculated as a percentage of revenues (Contract B and G).

Table 7 Basic management and incentive fees in the sample of seven management contracts in the hotel industry in developing countries

Contract	Basic management fee	Incentive fee
A	a) 6% of gross revenues derived from room sales; plus b) 5% of gross revenues from beverage sales; plus c) 2% of gross revenues derived from food sales	
B	3% of gross revenue	% of G.O.P. as specified below: 1st year - 7% 2nd year - 8% 3rd year - 9% 4th year and after - 10%
C	2% of gross revenue	5% of G.O.P.
D	3% of gross revenues	3% of G.O.P.
E		3.5% of G.O.P.
F	2% of gross receipts	25% of G.O.P.
G	3% of gross operating income	10% of G.O.P.

a) Gross Operating Profit

Source: Survey conducted by UNLMO Secretariat in 1983

Payments for the use of trade names were less prevalent and were found only in three of seven contracts surveyed. In Contracts B and G the Owner was obliged to pay a fixed amount of US\$2,500 as a trademark fee for each outdoor sign, whereas in Contract D the Owner bore the cost of registration of trade names in a given country.

With respect to payments for group services and the use of trade names, the more fundamental question arises as to whether such services should be remunerated at all. If their use contributes to the increase of turnover and profits, the Management Company also enjoys such positive effects in the form of increased value of management and incentive fees. In this case the Management Company is remunerated for the group services effectively used and not generally available for a given hotel.

Bearing in mind the complexity of the payment aspect in management contracts in the hotel industry, it is difficult at the present stage to offer detailed guidelines as to how the respective regulatory agencies in developing countries should deal with this problem. It seems however, that the variety of forms of remuneration is detrimental to the Owner and the host country as it becomes difficult to evaluate and control the execution of an agreement with respect to the equitable sharing of profits between the Management Company and the Owner.

Table 6 Payments for group services and the use of trade names in the sample of seven management contracts in the hotel industry in developing countries

Contract	Group services	Use of trade names
A	<p>"Neither MC nor any officer, director or affiliate shall charge or receive any profit for the rendition of any of the foregoing Group Services or for any services performed directly for the Hotel. MC shall however be entitled to charge the operation of the Hotel and to be reimbursed for all costs and expenses incurred by it in the rendition of said services as hereinabove defined or other services performed on behalf of more than one of the hotels operated by it including the Hotel."</p>	
B	<ol style="list-style-type: none"> 1) MC Reservation System (when available) <ul style="list-style-type: none"> - US\$3.- per room per month; 2) System-wide Advertising Service <ul style="list-style-type: none"> - US\$0.06 per room per night or 1% of gross rooms revenue, whichever is greater; 3) Reservation Sales Office Service <ul style="list-style-type: none"> - US\$0.06 per room per night or 0.8% of gross rooms revenue whichever is greater; 4) MC University <ul style="list-style-type: none"> - US\$0.01 per room per night. 	<p>For the outdoor Scripts or Crest Signs - one time fee of US\$2,500 for the use of each of such signs.</p>
C	<p>Owner is obliged to pay only out-of-pocket cost and expenses connected with providing such services</p>	
D	<p>The Hotel shall bear equitable pro rata share of the cost of such services. If the hotel is the sole subject of any advertising, the Hotel shall bear the full cost of such advertising</p>	<p>The cost of registration of trade shall be at the expense of the Hotel</p>
E	<p>At cost</p>	
F	<p>As an agreed participation by the Hotel in MC costs of international and local advertising, sales promotion and public relations, MC shall be entitled to spend in respect of each financial year's activities a percentage of gross operating income as follows:</p> <ul style="list-style-type: none"> - 2% for the first two financial years - 1.5% for the third and next financial years 	
G	<ol style="list-style-type: none"> 1) MC Reservation System <ul style="list-style-type: none"> - US\$3.00 per room per month plus Manager's premium for the complete package; these surcharges will not exceed 10% of the charge of the beginning of the year; 2) Occupancy fee <ul style="list-style-type: none"> - US\$0.06 per occupied room per night or 1% of the gross receipts for room occupation, whichever is greater; 3) Reservation fee <ul style="list-style-type: none"> - US\$0.04 per occupied room per night or 1% of gross receipts for room occupation, whichever is greater; 4) MC University <ul style="list-style-type: none"> - US\$0.01 per occupied room per night 	<p>The Owner agrees to make a single payment of US\$2,500 for each sign as a trademark.</p>

Source: Survey conducted by UNWTO Secretariat in 1983.

7. Other matters related to payments

a) Assurance of the minimum return on the Owner's investment

It is assumed that the various forms of remuneration as stipulated in the contract should cover the Management Company's expenses resulting from rendering such services and ensuring a fair profit. The Owner has however to evaluate the profit received against the amount of his capital investment. It may therefore happen that the revenues and profits satisfactory for the Manager are far behind for what would be required for ensuring an adequate return on Owner's investment. Therefore the provisions safeguarding minimum payments for the Owner are of crucial importance for the latter.

Such provisions were found in two contracts. In Contract A, minimum amounts of gross operating revenues and payments to the Owner are set. If during any three consecutive fiscal years after the first full fiscal year these minimum amounts are not met the Owner shall have the right to terminate the agreement on six month's written notice to the Management Company.

In Contract D the safeguard for the minimum return on the Owner's investment was stated more explicitly: "In the event in any year the net profit is not adequate to ensure a X per cent return on the Owner's investment (including any loan capital), the MC shall defer its claims for the incentive fee until the next or any subsequent year when by virtue of improvement in the operations of the Hotel there shall be sufficient funds for such payment to be made."

b) Use of standard accounting methods

As the various fees paid to the Manager are usually calculated as percentage of profits and revenues the accounting methods used have a direct impact on the actual value of payments to be made.

In the hotel industry the accounting methods used have been standardized to a substantial degree. The system adopted by the American Hotel and Motel Association known as the "Uniform System of Accounts for Hotels" is widely accepted. The reference to that system was made in contracts A, C, D, E. In contracts B and G respective provisions refer to the standard accounting practices adopted by the Management Company. Contract F does not contain any references to standard accounting methods.

Since it is difficult to precisely define all accounting principles, it is advisable that Owners in developing countries rely on internationally accepted rules. However, references to the internal standards adopted by a given transnational hotel chain should be avoided as this gives the Management Company a strong bargaining position in the disputes which may arise upon different views on accounting methods to be applied for calculating revenues and profits.

c) Provisions on the foreign remittances of payments to the Management Company

No provisions related to the payments remittances in foreign currencies were found in contracts A, B, C and E. It should however be born in mind that in Contract B some fees were given in US dollars and it might be understood that effective payments should be made in that currency.

The respective provision in contract D reads as follows:

"It is further understood and agreed that the obligations of the MC under this Agreement are subject to the following conditons:

MC shall have obtained, with the co-operation and assistance of the Owner, appropriate assurance from the proper authorities as to the right:

- (i) for key personnel needed to establish and operate Hotel, to be permitted to enter and work in the country and in some reasonable way be compensated in the currency of country of their domicile and repatriate a reasonable portion of said compensation;
- (ii) to realize, in United States Dollars, MC fee and reimbursements for expenditures made in currency other than that current in the country."

In Contract F the Owner is responsible for obtaining permission from the competent authorities to transfer abroad the amount of incentive fee in a foreign currency (management fee has not been mentioned) and 50 per cent of monthly salaries of the foreign personnel employed by the Management Company.

It might be argued that the payments in foreign currencies related to the management contracts should be carefully evaluated by the regulatory agencies. The lack of respective provisions in the approved contract might be interpreted as the permission for the Management Company to transmit abroad the total amount of remuneration it receives in various forms. For some payments e.g. salaries of expatriate staff such interpretation seems unjustified and might contribute to the increased burden on the balance of payments of the host country.

8. Duration and extension of the agreement

As it can be seen from Table 9 the initial term of the management contract usually does not exceed 10 years. In case of a longer period, the respective regulatory agencies usually insert a clause on reviewing the contract after the initial 10 years. As for the rights for extension of the agreements, the respective provisions resemble, to a certain degree, clauses on automatic renewal in the licensing contracts. Except for Contract F, the contracts formulate extension rights as being the privilege of the Management Company. In addition, the right of the Management Company to extend a contract is limited only by its default of any of the terms and conditions of the initial agreement. Therefore, such formulations as in Contract F : "The term of contract may be extended by mutual agreement between the parties" should be definitely preferred by the Owners and the respective regulatory agencies.

Table 9

Duration and conditions for extension of seven management contracts in
the hotel industry in developing countries

Contract	Initial term	Rights for extension
A	10 years ^{a/}	Management Company has option to renew the term for 3 successive periods for 10 years each.
B	10 years	Management Company has option to renew the agreement for 2 consecutive terms of 5 years each.
C	10 years	Management Company has the right to extend the term of agreement for 2 successive periods of 10 years each.
D	10 years	Management Company is entitled to extend the operating term for for a further period of 10 years.
E	10 years	Management Company has the option to renew the contract for additional 10 years subject to the approval of respective government agency.
F	15 years	The term of contract may be extended by mutual agreement between the parties.
G	10 years	Management Company has the option to renew the agreement for a period of 5 years.

^{a/} In the early version of the contract submitted for approval the initial term was set on 20 years.

Source: Survey conducted by UNIDO Secretariat in 1983.

9. Preferential right of purchase

The clauses on the preferential right of purchase were found in Contracts B, C and G. These clauses are quite similar and Contract B may serve as the example:

"If at any time or times during the term hereof Owner shall solicit and/or receive from a third party a bona fide offer acceptable to Owner, or which Owner does not promptly reject, to purchase the Hotel or any part thereof, Owner shall deliver to MC an executed original copy of such offer and agrees concurrently therewith to deliver to MC all financial information (including, but not limited to, certified balance sheets and operating statements) involved and such other information as may be reasonably requested by MC. MC may, within 21 days of its receipt of such offer and said financial data, at its option, contract to purchase said interest of said Owner on the terms of said offer. Failure of MC to exercise this option within said 21 day period shall free Owner to proceed with the third party."

It is worth noting that in case of execution ^{16/} of the preferential right of purchase the actual involvement of the Management Company in the operations of the hotel shall increase. Bearing in mind earlier discussion on the differences and similarities between management contracts and franchise agreements, no provisions were found in the seven contracts studied on the possible decrease of involvement of the Management Company. E.g. after expiration of the initial agreement the Owner might be willing to manage the hotel by himself, but is interested at the same time in using trade names and group services under franchise agreements. Such options had not been foreseen in any of the seven contracts. Bearing in mind the gradual increase of skilled personnel and managerial staff in the hotel industry, such "stepping-down" provisions should be included in the contracts in the interest of the Owner and the host developing country.

10. Applicable law

All the contracts studied surveyed stipulate that the agreement shall be construed, interpreted and applied in accordance with and shall be governed by the laws of the host country.

^{16/} Subject to the respective regulations on direct foreign investment in a given country.

IV. FRANCHISE AGREEMENT

1. Introductory remarks

The previous discussion on the differences and similarities between various forms of contractual arrangements used in the hotel industry has led to the conclusion that under the franchise agreement the foreign partner is not involved in the management of the hotel, whereas other services provided (especially group services) are in principle similar to that offered by the Management Company under standard management agreements. Therefore, many comments and suggestions made with reference to the management contracts can be applied to the franchise agreements, as well.

As a result of the survey conducted, the UNIDO secretariat gained access to one franchise agreement concluded with one of the largest transnational hotel chains. Therefore, the remarks and observations presented below are of a preliminary character and more general conclusions should be made after surveying a greater number of sample contracts.

The outline of the franchise agreement is given in Annex 2 below, giving the most important elements of the contract presented.

2. Services offered by the Franchisor

The services offered by the Franchisor are mostly those defined earlier as group services. Three types of such services might be distinguished:

a) General Services

These are services which are rendered by the Franchisor to all Franchisees in a standard manner. They include, among others:

- sales and reservation services

The Franchisor agrees to publicize the Hotel as a licensed member of the Group and to identify the Hotel in all its institutional publicity, brochures, price and information schedules, etc. He also agrees to place at the disposal of the Owner all his worldwide sales facilities as well as international communications and rapid reservation system by computer. The Owner however has to purchase or rent and install in the Hotel, at its own expense, all the necessary teletype communication equipment.

- information services

Franchisor agrees to deliver to the Owner all the information manuals and other material sent or delivered to the other members of the Group, under the same terms and conditions as these are sent or delivered to the other members. Franchisor shall place at the disposition of the Owner all its support materials for the promotion of sales, with training films for staff and information regarding new operational techniques, all under the same terms as they are placed at the disposal of other members of the Group.

b) Obligatory management and controlling services

The franchise contract analyzed in this report is not a "pure" one since the Franchisor is, to a certain degree, involved in the management of the hotel. Under this contract the Owner agrees that the Franchisor will designate a:

"Manager for the Hotel, subject to agreement by the Owner and the latter shall not unreasonably withhold such approval. The Manager shall be employed by the Franchisor and the Owner will provide for his complete sustenance and will reimburse the Franchisor for the cost of the Manager's salary and any relevant benefits due. The Manager shall be responsible for Hotel policy in co-operation with the Company, as well as for the supervision of the daily activities of the Hotel, and will answer to the General Manager."

The respective contract clause quoted above does not allow us to determine precisely the functions of the Manager designated and employed by the Franchisor and his position vis-à-vis the General Manager. However, he definitely represents the interests of the Franchisor and not the Owner. This may bring negative effects in view of the possible conflicts with the General Manager who should represent the Owner's interest.

The designation of the Manager is the major form of control of day-to-day operations of the Hotel by the Franchisor. In addition, the Owner is obliged to periodically deliver intelligence reports (including details of room occupation, forecasts, bookings for nights outside the Hotel, origins of reservations, etc.), when this is reasonably requested by the Franchisor. The Owner agrees also that the Franchisor's authorized representatives "shall have the right to enter the Hotel at any reasonable time during the contract period in order to determine the room occupation situation". The latter clause has to be seen in the context of the fee calculation which will be discussed later. A more general provision stipulates that the "Franchisor shall have the right to inspect the Hotel at any reasonable and opportune time in order to determine if said standards are being maintained".

c) Optional services

The optional services are provided by the Franchisor, depending upon whether these are requested by the Owner. The optional services include:

- purchasing services
- management and operational services
- technical services
- services providing live performances

Additional comments have to be made with respect to the optional character of the services mentioned above. First, the contract stipulated that the Owner authorizes the Franchisor to recommend a programme of redecoration for the hotel so that such services are to some extent obligatory for the Owner. On the other hand, the contract on the use of the purchasing services is being annexed to the main contract.

d) Use of trademarks

The Owner has the right and obligation to use the Franchisor's service and trademarks in the agreed forms and ways. He should however take advantage of the aforesaid commercial and service trademarks in such a way as to preserve and protect the Franchisor's ownership.

3. Remuneration for the services provided by the Franchisor

(a) Basic franchise fee

The Owner shall pay to the Franchisor a percentage of the total gross sales of rooms:

- 4 per cent if the annual room occupation is 75 per cent or less;
- 5-1/2 per cent if the annual room occupation is more than 75 per cent.

Regardless of the aforesaid, the Owner shall pay to the Franchisor a minimum retribution of X thousand US\$ per annum.

(b) Reimbursement of the salary of the Manager designated by the Franchisor

Although the Manager is directly employed by the Franchisor, the Owner is obliged to reimburse the salary and related expenses of the Manager. At the same time an upper limit has been set up for the Manager's salary designated by the Franchisor.

(c) Payment for the optional services

Except for purchasing services which are regulated by a separate contract, other services are remunerated according to the following formula:

- the Owner reimburses the payroll costs of personnel directly engaged on such services;
- the Owner reimburses all direct expenses relating to such services;
- the Owner pays the amount equal to 150 per cent of (a) to cover general and incidental expenses.

(d) Payments for the use of trademarks

The Owner does not pay for the use of trademarks. In addition, the respective stipulation in the contract makes it clear that all the costs relating to registration and the renewal of registration of commercial and service trademarks in the host country should be the exclusive responsibility of the Franchisor.

4. Other matters related to payments

a) Use of the standard accounting methods

The contract stipulates that the term "total gross sales of rooms" should be calculated in accordance with the Uniform System of Accounts for Hotels.

b) Payments in a foreign currency

The respective provision on this matter reads as follows:

"Unless the parties have come to some written agreement, all payments and wages and salary reimbursements (to the Franchisor) and all expenses in reimbursable US \$ in accordance with this Contract, shall be paid to the Franchisor at his Head Office in New York, and in currency recognised as legal tender in the USA".

In addition the contract requires that before the contract period comes into force, the Owner should obtain the approval of the remittance of said payments from the respective government authorities of the host country.

5. Duration and the extension of the agreement

The contract has been signed for the initial period of five years. "At the end of the initial period the contract will be automatically extended for a further period of five years; and subsequently, the contractual period shall not be renewed or extended without the mutual consent in writing of the contracting parties; however, if the average annual room occupation of the Hotel should amount to 80 per cent or more during the last three years of the first extension of the Contract period or during any other extension of this contract, same shall be automatically extended for an additional five years, always providing that said renewal is approved by the respective regulatory authorities."

Again, the above quoted clause defines the right for extension as the privilege of the Franchisor, whereas nothing has been said on the rights of the Franchisee.

6. Preferential option to management or lease

"If, at any time during the Contract period, or during any extension of same, the Franchisee considers that it would be in its interest to terminate the administration of the Hotel and lease, same to an international hotel chain, or contract the management of an international hotel chain, then the Franchisee agrees that it will first negotiate with the Franchisor. Should the Franchisor and the Franchisee fail to agree in said negotiations and the Franchisee receives an offer from some other hotel chain which the Franchisee is disposed to accept, then the latter shall immediately notify the Franchisor in writing of the offer and will give them a first ninety day option to contract with the Franchisee on the basis of the terms contained in the said offer. Should the Franchisor notify the Franchisee that it was not disposed to contract with the latter on the basis of the said terms and conditions, then the Franchisee shall have the right to contract with the other chain on the basis of the same terms and conditions; however, the period of the contract between the Franchisee and the other chain shall not start during the period or any extension of this Contract."

7. Applicable law

The contract is drafted and should be interpreted according to the law of the host country.

CONCLUSIONS AND RECOMMENDATIONS

Although the analysis of the contractual arrangements used in the hotel industry in developing countries was of a preliminary character, it revealed major problems arising from negotiating such arrangements. They result mostly from the fact that local partners in developing countries, when entering into negotiations of management contracts and franchise agreements are usually confronted with large transnational hotel chains which have world-wide experience in hotel operations and therefore have strong negotiating capabilities. The negotiation process usually starts with the draft standard agreement provided by the foreign partner. Obviously, the clauses in such contracts are drafted usually in such a way as to protect the interest of the foreign partner. The local partner may re-draft some formulations and insert additional provisions but this may only partially improve the terms and conditions of the contract.

Bearing in mind the future development of the outward-looking hotel industry in developing countries and projected growth of the number of contractual arrangements covering transfer of technology in this industry it is recommended that the work on respective contractual arrangements should be continued within the activities of the TIES system. Taking into account that other organizations, namely World Tourist Organization and UN Centre on Transnational Corporations are also active in that field, the programme of work within UNIDO's TIES system should concentrate on technological aspects, i.e. transfer of skilled personnel, expertise, technological content of services provided, etc., and the resulting financial flows. For the government regulatory agencies, a set of model clauses safeguarding effective flows of the "real" technology into the hotel industry and protecting the interest of the local partner would definitely be a useful tool to be used in the process of registration and approval of management and franchise agreements. The forms and levels of payments especially in the management contracts require a more detailed investigation as this matter is probably more complicated than in standard licensing agreements. Such an analysis may eventually lead to the elaboration of the guidelines for the payments in the service

agreements in the hotel industry similar to those already applied to the manufacturing sector.^{17/}

More detailed investigation is needed for the franchise agreements viewed as an alternative to the management contracts presently being predominantly used in the hotel industry.

The effectiveness of UNIDO's work in the above-mentioned fields may be substantially increased by establishing close contacts and co-operation with other organizations, i.e. CTC ^{18/} and WTO. In addition to the co-ordination of work and exchange of results of surveys and studies, workshops, training and technical assistance programmes for the business community in the hotel industry in developing countries could be organized with joint participation of these organizations.^{19/}

^{17/} See "Guidelines for Technology Transfer Payment Evaluation", UNIDO, ID/WG.383/1, Vienna, 1982

^{18/} Within its area of work CTC has collected and analyzed 35 management contracts concluded in various industries in developing countries. See "Management Contracts in Developing Countries: An Analysis of Their Substantive Provisions", UNIDO, ID/WG.337/7, Vienna, 1981

^{19/} Especially WTO is actively engaged in organizing variety of training programmes for the representatives of the hotel industry in developing countries.

Annex 1

OUTLINE OF A TYPICAL MANAGEMENT CONTRACT ^{1/}

- ARTICLE I Selection of site and construction, furnishing and equipping of the hotel
- Section 1 The site
 - Section 2 Construction, furnishing and equipping of the hotel
 - Section 3 Technical assistance services
 - Section 4 Title to the hotel
 - Section 5 Fund for training, pre-opening and opening expenses
 - Section 6 Opening of the hotel
- ARTICLE II Operating term
- ARTICLE III Use and operation of the hotel
- ARTICLE IV Management fee and payment to first party
- Section 1 Basic management fee
 - Section 2 Incentive fee
 - Section 3 Payment to first party
 - Section 4 Supplemental payment to first party
 - Section 5 Fiscal years
- ARTICLE V Determination of gross operating profit
- Section 1 Books and records
 - Section 2 Gross operating profit
 - Section 3 Provision for replacements of operating equipment and uniforms
 - Section 4 Fund for replacements of and additions to furnishings and equipment
- ARTICLE VI Repairs and changes
- Section 1 Repairs and maintenance
 - Section 2 Alterations
 - Section 3 Essential repairs, changes and replacements
 - Section 4 Other alterations

^{1/} Included by courtesy of Hilton International Co. in the WTO study "Accommodation . . . ", op. cit, Appendix C and confirmed by the survey conducted by UNIDO Secretariat.

ARTICLE VII	General covenants of management company and first party
Section 1	Opening inventories and working capital
Section 2	Group services and benefits
Section 3	Right of inspection and review
Section 4	Reports
ARTICLE VIII	Insurance
Section 1	Insurance to be maintained by first party
Section 2	Insurance to be maintained by management company
ARTICLE IX	Damage to and destruction of the hotel
ARTICLE X	Condemnation
ARTICLE XI	Right to perform covenants and reimbursement
ARTICLE XII	Defaults
ARTICLE XIII	Trade name
ARTICLE XIV	Arbitration
ARTICLE XV	Extension
ARTICLE XVI	Successors and assigns
Section 1	Assignment by management company
Section 2	Assignment by first party
Section 3	Successors and assigns
ARTICLE XVII	Further instruments
ARTICLE XVIII	Notices
ARTICLE XIX	Applicable law
ARTICLE XX	Partial invalidity
ARTICLE XXI	Special conditions

Annex 2

OUTLINE OF THE FRANCHISE AGREEMENT

Article I	Duration of the Contract
Article II	General Services
	A. Sales and reservation services
	B. Information services
Article III	Optional Services
	A. Purchasing services
	B. Management and operational services
	C. Technical services
	D. Services providing live performances
Article IV	Payments to Franchisor
	A.1. General services
	A.2. Manager
	B. Optional services
Article V	Special Agreements between the Parties
Article VI	Insurance and Indemnities
Article VII	Cases of Default
Article VIII	Annulment
Article IX	Extension of the Contract
Article X	Transfer
Article XI	Option to Administer or Lease
Article XII	Various Provisions
	A. Relationship of the parties
	B. Arbitration
	C. Notification
	D. Successors and Transferees
	E. Separability of the Provisions
	F. Copies
	G. Law of Adjudication
	H. Headings and Index
	I. Domicile
Annex A.	Purchasing Contract
Annex B.	Name of the Hotel
Annex C.	Remuneration

