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GUIDELINES FOR THE EVALUATION OF CONTRACTUAL ARRANGEMENTS IN THE HOTEL INDUSTRY IN DEVELOPING COUNTRIES*

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INTRODUCTION

Since the mid-1960s a rapid development of international tourism in developing countries has been observed. During the 1965-1976 period tourist arrivals in developing countries increased by 12 per cent per annum as compared to 5 per cent per annum in developed countries.[1/] This coincided with the growing international involvement of the hotel operations in developing countries, mostly through the expansion of large transnational hotel chains in this region. This trend is reflected not only in those countries with favourable climatic conditions for attracting vacational tourists, but also in other countries, as business travellers have become the most dynamic segment of the market.

As a result various government agencies responsible for the formulation and implementation of industrialization policies have been confronted with the necessity of developing a modern hotel industry in their countries. Among the agencies affected are those dealing with the evaluation, approval and monitoring of investment projects, direct foreign investment, transfer of technology and foreign payments. They perform their functions, inter alia, by screening the contractual arrangements concluded between local and foreign partners which are used for the implementation of development projects.

In view of the growing number of hotel contracts submitted for evaluation and registration, their complexity and distinctive features made it evident that the government staff responsible for approval of such contracts lack the necessary knowledge and experience in this area. This in turn was the major obstacle in performing the regulatory functions by the respective government agencies. As a result the government institutions in developing countries dealing with technology transfer and participating in UNIDO's co-operative scheme called Technological Information Exchange System (TIES) requested the UNIDO Secretariat to undertake a study and prepare guidelines for the treatment and evaluation of the various types of agreements used in the hotel industry.[2/]

While complying with the above recommendation the UNIDO secretariat commissioned a preliminary study on the subject which was completed in 1983.[3/] The study covered the analysis of the overall trends and major policy options with regard to the scope and forms of foreign participation in the hotel industry in developing countries. It also contained an empirical analysis of the major provisions based on a sample of eight agreements provided by technology transfer registries from selected developing countries. The study was discussed during the eighth TIES Meeting which formulated the suggestions and recommendations as to the future course of action in that area.

The present report has to be viewed as a follow-up of the previous study. Unlike the former, it deals exclusively with the contractual aspects of the administration and management of foreign-linked hotels in developing countries. It should be stressed that the empirical background for the second study was much broader as it was possible to collect nineteen sample contracts from six developing countries. The analysis of the substantive provisions was carried out in order to formulate detailed recommendations with a view to providing assistance to the staff of government institutions dealing with the approval and monitoring of such contracts.[4/]

Consequently, only selected aspects of contractual arrangements have been taken into consideration, i.e. those which may, directly or indirectly, affect the national interest represented by the government. Thus the present study should not be viewed as a manual for drafting and/or negotiating contracts for operating foreign-linked hotels in developing countries.[5/] It should also be made clear that the evaluation of the respective provisions and recommendations are based on protecting the interests of the recipient country and to some extent those local partners.

The access to the relatively broad sample of contracts concluded or currently negotiated in the hotel industry in developing countries had a profound impact on the scope and final results of the study. Firstly, it helped to identify major trends and methods for defining various problems in the contracts, taking into account the distinct features of the hotel industry. As a result it was possible to formulate pragmatic recommendations with due consideration of the traditions, standards and patterns prevailing in the hotel industry. Secondly, the areas where the interests of the recipient country were unsatisfactorily protected have been identified and due attention paid to them while formulating the recommendations. Last but not least, the examples of the clauses adequately safeguarding the interests of the recipient country and the local partner were also found in the contracts surveyed. They were often quoted in the Guidelines as a useful reference material.

The major difficulty encountered in the course of elaborating the Guidelines resulted from the fact that the legislative and administrative framework for government intervention in foreign collaboration arrangements as well as practical experience in that area differed substantially between the different developing countries. For obvious reasons, local conditions and their implications could not be adequately covered in a general-type study where a "middle of the road" approach is adopted. It should therefore be made clear that the proposed concepts and detailed recommendations are not universally applicable and should be taken into consideration with the local environment. The above comment is meant as a general cautionary note since the usual "warning", has been omitted due to limited space.

The study consists of five chapters. The first chapter contains a systematic overview of contractual arrangements used in the hotel industry with an attempt at providing a conceptual framework for classifying contracts used in this sector and identifying major problems in the field. In the second chapter an analysis of contractual provisions defining the services offered by the foreign partner is conducted. The question of restrictive clauses enabling excessive control of hotel operations by the foreign partner is covered in chapter III. Chapter IV deals with the most essential issue, i.e. payments accruing to the foreign partner. Finally, in chapter V the provisions relating to contract duration and extension are discussed.

II. CONTRACTUAL ARRANGEMENTS USED IN THE HOTEL INDUSTRY - AN OVERVIEW

1. Introductory remarks

The standard procedure for contract evaluating for registration purposes usually starts with a general analysis of the contract clauses aimed at identifying the type of contract and its coverage. Naturally such an analysis leads to the classifying of a given contract within one of the standard categories, e.g. management agreement, franchise agreement, licensing agreement, etc. The empirical data collected by the UNIDO Secretariat revealed that the question of typology and classififying contracts in the hotel industry is complicated and may have an essential effect on the evaluation procedure. In the following section we shall clarify some critical issues while offering some practical solutions for major problems encountered during the evaluation process.

2. Types of contractual arrangements used in the hotel industry in developing countries

The following contractual arrangements are mostly used between transnational hotel chains and their 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.

Equity ownership does not play an important role in the hotel industry in developing countries, and in most cases the foreign partner has a minority interest only. In fact the share of arrangements with foreign equity participation has drastically fallen since 1975. The same applies to leasing arrangements and to some extent to franchise agreements. Management contracts on the other hand are gaining in 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.[6/]

3. Brief description of non-equity arrangements[7/]

a) 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 hotel's gross operating profits. Usually the tenant pays between sixty and eighty per cent of the hotel's profits to the owner after deduction of expenses connected with losses which are carried by the tenant who manages the hotel and who 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 leasing contracts is usually for a period of twenty years.

b) Management contracts

A management contract is an agency agreement between a managing company and the property owner, whereby the managing 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 a 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 a management contract, the managing company provides 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.

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

c) Franchise agreements

Under a franchise agreement the owner (franchisee) is allowed, for a fee, to use the name, trademarks and various services offered by the franchisor. The fee usually comprises a fixed sum plus a percentage commission on rooms. The set of services provided by the franchisor includes a worldwide communications and reservations 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.

Franchise agreements normally run for 10 to 20 years.

4. Results of the empirical survey with respect to the types of contractual arrangements used in the hotel industry

At first glance the results of the empirical survey seem to confirm the general trends as to the use of contractual arrangements outlined above. The overwhelming majority of contracts, where the formal title was indicated, bore the name "management agreement". Only one leasing and one franchise contract were identified. However a more detailed analysis of the respective provisions led to the conclusion that practically all contracts surveyed were of a "composite" character. Obviously the key element for involving the foreign partner was his managerial function. However the crucial and distinctive feature of the management function in the hotel industry is that the hotel is operated within the framework of an international chain. As a result the rendering of additional services is viewed as an integral part of the whole undertaking, and is consequently covered by the management agreement. Additional services include so called group services as well as various technical services rendered during the pre-operational and operational phases.[8/] It may therefore be concluded that the "composite

chain management agreement" is the most popular type of contract used in the hotel trade reflecting the standard level of involvement of the foreign partner. A higher degree of foreign involvement may be observed in leasing arrangements where the foreign partner manages the hotel in his own name as well as arrangements where managerial and technical services are accompanied by minority interests. A lower involvement occurs in standard franchise agreements where the managerial function is eliminated from the package or eventually replaced by advisory management services.

The survey confirmed a general pattern of limited foreign equity participation in the hotel industry. It also revealed the diversity of equity relationships which may exist parallel to contractual arrangements. No standard case of foreign majority or minority equity participation were found in the sample. However, in one agreement the foreign partner had equity interests in a joint venture company serving as an operator of the hotel. The second management contract was concluded between the chain operating company and its wholly owned foreign subsidiary whereas the latter entered into a lease arrangement with the local hotel owner.

Normally all major elements of the relationship between foreign and local partners were covered in one agreement. Some areas of co-operation were also left to be defined in a separate "associated" contract mentioned in the main agreement. On the other hand, one leading transnational chain followed the pattern of signing the set of separate but interlinked agreements. The package covered a management agreement, a licence agreement, a technical service agreement and a reservation service agreement.

The empirical survey also helped to investigate the degree of standardization of contract formats used in the hotel industry. In general the degree of unification of the structure of the contract and the formulation of basic provisions was found to be relatively low. It was quite interesting to note that major differences in that field were also found in contracts signed by the same transnational chain with partners in various countries. It was clear that standard formats were

often used by large hotel chains during the first phase whereas in the course of negotiations some essential provisions were substantially modified. The above observation may lead to the conclusion that tough negotiations may result in a substantial revision of the contract condition including such crucial elements such as payments or issues relating to the control of hotel operations.

5. Suggested approach to the classification of contractual arrangements in the hotel industry

In view of the results of the empirical analysis it may be concluded that the classification of contractual arrangements by using standard categories or official titles of agreements can be misleading as the majority of such contracts are of a composite character. Alternatively, they may be distinguished by defining the scope of involvement, i.e. resources, services and benefits effectively provided by the foreign partner. The suggested classification based upon such a concept and which may be useful for contract evaluation is given in Table 1.

In the consecutive chapters we shall discuss various aspects of contractual relationships bearing in mind that the most popular type of contract in the hotel industry is the composite chain management agreement. However the detailed conclusions and recommendations are valid for other arrangements as well with due consideration to the contents of the "package". For example one can refer to guidelines in the course of evaluating franchise agreements while omitting the paragraphs relating to management functions performed by the foreign partner.

Table 1

Classification of contractual arrangements in the hotel industry based on the scope of effective involvement of the foreign partner

Type of contractual	Types of services and/or resources provided by the foreign partner				
	Equity investment Majority/minority	Management function in the own name/in the owner's name		Group services ind. trademarks	Technical assistance
1. Wholly or majority-owned subsidiary	X	X		X	X
2. Composite chain leasing agreement with minority equity participation	X	X		X	X
3. Composite chain leasing agreement		X		X	X
4. Composite chain management contract with minority equity participation	X		X	X	X
5. Composite chain management contract			X	X	X
6. Composite franchise agreement with minority equity participation	X			X	X
7. Composite franchise agreement				X	X

II. SCOPE OF SERVICES RENDERED BY THE FOREIGN PARTNER

1. Introductory remarks

The services covered by the foreign partner represent the inflow of know-how, expertise and other benefits into the recipient country. The registries review the respective contract provisions in order to make sure that the real inflow of technology is being effectively safeguarded under the terms of the agreement. They also define whether the scope of services set out in the contract maximize the benefits for the local partner and the recipient country and justify the level of remuneration.

In the following paragraphs we shall discuss the issues associated with defining managerial services, so called group services and the various technical assistance services in the contracts concluded for the hotel industry.

2. Provisions related to management function and related activities

2.1 Pre-opening programme

The standard hotel management contract usually allows for a certain period of time after construction (e.g. six months) before the official opening of the hotel to be used by the managing company (MC) for pre-operational staffing, training, organization, advertising, promotion, etc. During this period the effective transmission of experience and know-how, which is of utmost importance for the smooth operation of the hotel after formal opening takes place.

An analysis of the respective provisions in the contract surveyed revealed a general trend towards resolving financial matters concerning the pre-opening programme (this will be discussed in the next chapter). With respect to the scope of services to be provided by the MC, this is either very vaguely defined or reference is made to the plan for the pre-opening programme to be prepared by the MC and mutually agreed by the latter and the owner. Unfortunately, such plans are usually of a financial character as they contain specifications and expected timing of expenditures for the pre-opening programme.

Quite often the pre-opening programme is already annexed to the main agreement (in the case where financial provisions for the pre-opening programme are made in the contract this shall be deemed obligatory). Under such circumstances the registry may request that such a programme specifies in detail the scope of services to be provided by the managing company at this stage.

2.2 Definition of activities and services provided by the managing company during the operational stage

The contractual arrangements studied differ substantially as to the definition of managerial services provided by the managing company (MC). In some cases the agreements refer simply to the international standards in the hotel industry, e.g.

> The "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 defining the scope of management services is to refer to the international standards applied world-wide by a given transnational chain, e.g.

> The "MC shall operate the hotel as a 'MC' hotel at the expense of the Owner in accordance with the provisions of the agreement hereinafter appearing and in accordance with MC international standards. The 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 the MC in the operation of other 'MC' hotels, the right of revision and amendment of such being reserved by the MC."

In several contracts either more elaborate lists of MC duties were provided or a general definition was supplemented by specific provisions in some crucial areas such as the hiring and training of personnel.

The broader, elaborated definition of managerial services has certain advantages over the previously mentioned options. It enables the setting of priorities with respect to some areas of MC activities which are essential for both the owner and recipient country. It shall also facilitate the periodical review of the effects of contract implementation, especially while resolving the question of its extension. In view of the above, the registries are advised to insist on a more detailed definition of the services provided by the managing company.

2.3 Provisions related to training

It has to be emphasized that the training of local staff usually starts before the opening of the hotel and it can be seen as the most important element of the pre-opening programme, from the owner's point of view. In that area a discrepancy of interest may arise especially with respect to the training of senior staff who are expected to replace expatriates occupying key positions. The managing company may wish to retain expatriates for longer periods of time thus delaying the intensive training of nationals expected to take over such positions.

The registries are therefore advised to carefully review the provisions on training during the pre-opening phase and if necessary suggest inserting detailed clauses specifically relating to the training of senior staff. The formulation drawn from one Nigerian contract may serve as a useful reference:

> "Approximately six months prior to the formal opening of the hotel, the MC shall hire about six Nigerian nationals, each of whom must have an adequate educational background. The MC objective will be to train such Nigerians so that, following their training, they will be able to assume the positions of assistants to department heads. Upon recruitment they will be sent to the hotels operated by the MC where they will be trained in the MC system of hotel management.....The training programme will be controlled by the use of check lists, projects and periodic appraisals of each trainee's progress, all in accordance with the MC training manual".

In the course of a hotel's operation a natural transmission of knowledge and experience takes place, mostly through on-the-job-training. This process can however be further accelerated by specialized training programmes organized by the managing company either within the country or abroad, in the hotels operated by managing company. The necessity for organized training arises in the first place because senior staff should be seen in close relationship with the problem of replacing expatriates occupying key positions by nationals as discussed above. The training organized at the company level should be regarded as an essential contribution to the development of human resources for the modern hotel industry in developing countries and so that the registries may carefully evaluate the respective contractual provisions.

Among the agreements surveyed, the majority either had no provisions dealing with training or the requirements for conducting such programmes were stipulated in general terms under duties of the managing company. In some cases attempts were made to more precisely define the obligations of the managing company in that area. This might be achieved by listing management positions requiring concentrated training efforts to be conducted at home or abroad. In two contracts the elaborated training programmes were presented as an annex to the main contract. Such programmes defined the scope, objectives, priorities, forms and methods, together with organizational and financial considerations. In one agreement the training of local staff had been directly linked with the programme of indigenization of expatriate staff by tentatively specifying the timing of the take over of key positions by nationals e.g.

> "The MC recognizes the necessity of Nigerianization of all posts as directed by the Owner within the period of 5 years and the MC shall use its best endeavours to train and retain senior Nigerian staff for such posts".

The inclusion of the well elaborated provisions specifying the obligations of the managing company in the field of training of local staff should be strongly encouraged by the registries. The incidence of such clauses generally reflects the owner's orientation towards long-term development objectives which is in the best interests of the recipient country.

2.4 Provisions related to local versus foreign procurement

The question of local versus foreign procurement shall be considered within the broader context of development policies aimed at lowering the import dependency of national economies. Due to a substantial degree of standardization in chain operations and the need for attaining the highest quality in the established international purchasing system, there is an obvious tendency on the part of the managing company to rely largely on imports especially when the imported items are purchased from or through subsidiary companies. Thus alternative sources of supply of acceptable quality goods readily found in local market of many developing countries are often overlooked.

In view of the above, the registries should insist on inserting specific provisions into the contract which clearly reflect the preference given to local procurement, e.g.:

> "In all stages of the project, the managing company, contractors and subcontractors shall give preference to the use of products of the host country unless such products are not available on a competitive basis, such as delivery, quality, quantity, availability and cost".

Unfortunately, such clauses are rarely found in contracts concluded between partners from developing countries and large international hotel chains. On the other hand, several agreements contain provisions specifying conditions for using the managing company or its subsidiary companies as purchasing agents outside the national market.

Special consideration will be given to purchases from and/or through subsidiaries of the managing company. The intra-firm transactions are often used for the purpose of transmitting funds abroad by overpricing imported elements. Unfortunately, such abusive practices are extremely difficult to eliminate. To some extent well drafted provisions stipulating specific procedures for intra-firm transactions in the contract could serve that purpose, e.g.:

> "In its management of the hotel, the managing company may, subject to the approval of the owner, purchase goods, supplies and services from or through any of its affiliated or subsidiary companies as long as the prices and terms thereof are competitive with the prices and the terms of goods, supplies and services of equal quality available from third parties".

3. Group services

Group services are considered as the second major category of services rendered by the managing company to the owner (in addition to the managerial services and technical assistance provided during pre-operational and operational phases). As a rule services are rendered universally to all hotels who are members of a given chain. Generally, the group services include:

- general (supply of standard operating manuals, research and statistical reports, etc.)
- sales and promotion (advertising, distribution of hotel brochures, participation in sales programme of airlines, participation in public relations and inclusion of the name of the hotel in all brochures published by a given chain, etc.)
- reservation system (inclusion of the hotel in a world-wide reservation system operated by a given chain and systems of other organizations such as airlines, American Express, etc.)
- centralized training system (e.g. the Holiday Inn University established by the chain for conducting specialized training for the staff of hotels belonging to this group).

In view of the distinctive features discussed above, the flexibility with respect to the use of such services by the owner are very limited as they usually become an integral part of the operating standards of the whole chain. It should be born in mind that the group services are normally linked with additional payments to the managing company (to be discussed in the next chapter). The registry should therefore review the relevant clauses defining group services in an attempt to relate potential benefits to the payments to be made.

The important question to be resolved is the incidence of group services at all. This applies especially to the smaller hotel organizations who do not enjoy a worldwide reputation and where the "image" and facilities of the chain have a minimal effect on the operation of a given hotel. In fact, in a number of agreements concluded with smaller hotel organizations nothing was mentioned concerning group services and related payments. The registry should, in principle favour such a solution.

The second problem to be looked into is the specification of group services in the contract. In the majority of contracts surveyed, only major categories of group services were mentioned (e.g. advertising, promotion, reservation), whereas the details of their rendering are left to the standard procedures used in a given chain. Yet a detailed checklist of the group services could be very helpful for negotiation purpose as well as for evaluating an agreement. The registry should therefore suggest amending and/or extending the respective clauses.

The third aspect is the case of straight forward clauses expressing an obligation to provide the aforesaid services to the best ability. Unfortunately, typical clauses found in the sample merely stated the availability of such services and benefits nothwithstanding the obligatory payments for such services. The preferred formulation could read, as follows:

> "The Managing Company must provide, or ensure that its subsidiary companies provide the following services during the operation of the hotel and for the benefit of its guests, (herewith follows a detailed list of services)".

4. Use of trade names

The use of all service marks, trademarks, signs etc. being the property of a given hotel chain becomes part of the group services and benefits, but due to certain aspects associated with the transmission of property rights we shall discuss this problem separately.

The analysis of the sample contracts revealed a substantial degree of standarization of provisions related to the use of trade names. Almost all composite agreements surveyed contained clauses which were identical or very similar to that quoted below:

> "During the operating term the hotel shall at all times be known and designated as X except as may otherwise be mutually agreed upon by the owner and the MC. It is recognized however that the names X and Y are the exclusive property of the MC. Consequently, no right or remedy of the owner due to any breach of contract, or the handing over of possession of the hotel to the owner upon expiry or early termination of this agreement, nor any provision of this agreement shall confer to the owner the right to use the name X"

Thus, in a standard formulation the exclusive ownership rights of all service marks, trademarks, trade names, etc. by the managing company are clearly spelled out. This is further reinforced by the obligatory cessation of the use of trade names by the owner upon expiry or early termination of the agreement. The manner in which the benefits of the use of trade names are formulated in the contracts requires additional comment. Definitely the owner is granted the right to use the aforesaid trade names, but at the same time there is an inherent element of obligation under such a relationship. Firstly, the use of trade names is practically indispensable for rendering managerial and group services in a typical hotel contract. Secondly, the managing company benefits from the use of its name by the owner, as this promotes the whole chain.

The above comments could be useful when considering the example of a leading transnational hotel chain which follows the practice of signing separate licence agreement in addition to management contracts. Under a licence agreement the company grants (against separate royalty payment) the right to use its trademarks, trade names, slogans, symbols, etc.

Without going into detail it may be advisable that arrangements as presented above are not inserted into composite hotel management agreements, despite the fact that the use of separate trademark licence is against tradition and current standard practices of the industry.

5. Provisions relating to technical services

The contractual provisions covering additional technical services by the managing company relate mostly to the construction phase. The company operating the international hotel chain usually accumulates substantial experience in the designing and planning of modern hotels and the need for rendering such services is often indispensable in order to meet the standard requirements imposed under the terms of the contract.

Except for a few contracts where the question of technical assistance during the construction period is not mentioned at all, the majority of contracts contained respective clauses but differed as to the extent of detail. A typical general-type formulation reads as follows:

> "The MC agrees that it will make available its technical assistance service embodying its unique experience in the designing and planning of modern hotels by causing its specialists regularly or specially employed or retained by it to provide advice, guidance and supervision to the owner and its agents in connection with planning, designing, equipping, decorating and furnishing of the building and the designing, selection and purchasing of furniture and equipment, and by providing a project coordinator and manager for the purpose of coordinating and effectuating the work of the various agents and specialists".

At the other extreme a very detailed identification of services to be rendered by the managing company during construction was found in one contract. In a separate appendix a list of 35 types of services with a breakdown into eight different categories was provided.

In principle the provisions defining the obligation of the manager to share his/her experience with the owner regarding design, planning and construction should be included in the agreement but their formulation will depend on the type and form of remuneration. If such services are to be provided without profit or fee (only cost incurred to be reimbursed by the owner) the general type of formulation may be sufficient. If, however, the managing company is remunerated in the form of a fixed fee, then the registry should insist on a very detailed description of the scope of services in the contract.

The technical services rendered during the operational phase are generally covered by a general-type of provision together with the group services. The latter occurs when the compensation for both categories of services is based on the same principle (at cost).

The question of purchasing services already mentioned in para. 2.4 calls for careful consideration during the process of evaluating contracts. In fact, one leading international hotel chain introduced a unified system whereby the managing company acts as a purchasing agent for the other members of the chain. Bearing in mind the overall policy aimed at decreasing import dependency as already discussed in the previous chapter, the registry should make sure that the purchasing services are clearly defined as optional. In order to avoid any misunderstanding in that area, it is advisable that the detailed provisions on purchasing services be eliminated from the main body of the contract. If necessary they can be formulated in a separate agreement subject to additional administrative procedures.

III. CONTROL OF HOTEL OPERATIONS

1. Introductory comments

The delineation of the rights of both partners in controlling the hotel's operations is one of the most controversial issues during the negotiations of the composite management agreements in the international hotel industry. This is largely because the interests of the owner and managing company in that area are very much in conflict. The managing

company usually aims at retaining full control over the operations of the hotel by rendering to the minimum any possible interference on the part of the owner. The negative examples of such interference, such as excessive demands to provide free room and board for the family and business friends of the owner, are widely quoted amongst the industry's circles. On the other hand it is obvious that the owner while retaining ownership rights cannot resign from participating in crucial decisions on the long-term aspects of the hotel's activities. This is essential in view of the fact that hotel contracts usually extend over longer periods as compared to those concluded in the manufacturing industry (see Chapter 1).

The above issues are dealt with by registries in a more general manner without going into details of owner/manager relationships. The respective clauses are screened during the evaluation process with a view to eliminating restrictive clauses prohibited by law in a given country. Generally, the registry is also interested in strengthening the bargaining power of the owner vis-a-vis the managing company as this shall provide for a better framework towards achieving the development objectives in the course of contract implementation.

2. Control of the construction process

In the majority of contracts surveyed which related to newly built hotels the managing company's control was safeguarded by provisions requiring the approval of contracts concluded with third parties or construction of the hotel, e.g.:

> "The owner must contract and keep on its own behalf, all architects, contractors, engineers, decorators, landscape architects and any other specialists and consultants who may be necessary and appropriate. Each of the contracts concluded with the aforesaid persons must be previously approved by the MC and the relevant plans, designs, specifications and drawings must be submitted for approval by the owner and the MC before being implemented."

Alternatively, the agreements imposed an obligation on the owner to comply with the managing company worldwide, e.g.:

> "The owner agrees to complete construction of the building at its expense in conformity with the project plans and specifications and according to the MC's standards (a copy of which the owner agrees to having received recently)... The owner agrees to furnish and equip the hotel with the necessary furniture, equipment and functional supplies in accordance with the MC's standards".

With due consideration to the standarization and uniformity of hotels operated by renouned hotel chains such restrictive, one-sided formulations may indirectly affect the interests of the owner and the recipient country. For example the managing company may insist that one comply with its standards in areas of minor importance or request that locally available furniture and supplies be imported. Therefore the registry should suggest the modification of the respective clauses in such a manner that the mutual agreement of the owner and managing company is required while resolving all questions during the construction phase.

The example of one contract concluded in Malaysia indicated that even slight modifications might well serve that purpose. In the relevant section of the contract the formulation:

> "subject to prior written approval of the manager" has been modified so as to read:
> "subject to mutual approval in writing of the owner and the manager".

3. Control exerted by the managing company during the operational phase

An analysis of the sample provisions revealed the incidence of the "standard clause" which fully protected the interests of the owner with respect to the control issue. An example of this formulation is given below:

> "It is understood that the 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 the 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 the MC shall include and extend to, among others, 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."

For obvious reasons, such a formulation cannot be accepted by the owner or the registry as it is restrictive and extremely one-sided. On the other hand examples of a balanced formulation were also found in the sample. These were based on the rational assumption that the owner shall not be involved in the day-to-day operations of the hotel but should retain the right to decide (jointly with the managing company) on key matters that have long-term implications. This can be achieved by specifying those matters which are the prerogatives of the owner in the contract (his Board of Directors) e.g.:

"The MC shall manage and operate the hotel on behalf of the owner. The MC shall be responsible for the complete management and operation of the hotel except for those matters relative to the following list which the MC acknowledges as being the pererogatives of the Board of Directors:

- terms and conditions of employment of all staff;
- room rates, food menu prices, beverage prices".

4. Control of key personnel

The effective control of business operations is accomplished through key executive staff and the conflicting interests of the managing company and the owner are clearly reflected in the area of personnel policies. Basically, the owner may retain control of crucial matters

pertaining to hotel operations, providing he has the final say on the appointment and discharge of key personnel. Unfortunately, the acceptance of the clause expressing full control of hotel operations by the managing company quoted in a previous paragraph practically eliminates any influence of the owner in this crucial area. This is further emphasized by the standard practice of hotel business whereby key expatriate staff remain on the managing company payroll.[9/]

However a number of contracts surveyed contained clauses safeguarding the owner's interest in this matter. Two examples can be quoted:

- the General Manager and other key personnel are selected by the management company subject to the approval of the owner, e.g.:

"The designation by the managing company of each General Manager and department head shall be subject to the approval of the owner, which shall not be unreasonably witheld or delayed",

- within broad personnel policies defined by the owner the managing company was authorized to designate a specified number of their own employees or other appropriate and qualified persons to occupy key positions in the hotel.

It seems that a number of alternative formulations for the respective contract clauses may effectively safeguard the real influence of the owner on key personnel decisions. It is however recommended that registries consider the explicit provision of the owner's right to finally approve the appointment of the hotel General Manager to be of minimal importance.

Another aspect within a broader framework of personnel matters is the question of employment of expatriate personnel in hotels operated by international chains. Basically, developing countries tend to restrict excessive employment of expatriates in view of the growing availability of highly qualified and capable nationals, who very often face severe obstacles in finding suitable jobs.

The rigid, one-sided provisions in the examples scrutinized invested the managing company with full discretion in respect of hiring expatriate personnel whereas the owner was required to collaborate in obtaining visas, work permits etc. For obvious reasons such clauses should not be viewed as being satisfactory by the registry. Several seemingly acceptable options were found in the sample, e.g.:

- the Manager was explicitly authorized to hire foreign personnel, the number of such personnel and their positions being clearly spelled out in the contract;

- the right to hire expatriates depended on the availability of qualified local staff, e.g.:

- The "MC shall be entitled to engage foreign personnel, if such are not available among the citizens of X country, and the MC undertakes to train suitable local personnel within the shortest practicable time ..... The 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 the MC as necessary for the success of the operation.";

- the right to employ specified numbers of key expatriates was linked with an obligation to create a framework for effective on-the-job training, e.g.:

  "The MC is entitled to second up to but not more than, nine of their own employees or other appropriate and qualified persons ... provided the owner shall have the right, with the consent of the MC to provide among its own employees nine qualified persons to hold the positions of deputies to and understudy those seconded".

It is recommended that the registries do not accept contract clauses giving absolute discretion to the managing company in the hiring of expatriate staff. It is advisable that the priority for employing nationals shall be clearly stipulated in the contract.

IV. REMUNERATION TO THE FOREIGN PARTNER

1. Introductory remarks

Usually the analysis of contractual provisions relating to payments constitute a most important part of the evaluation process of technology transfer agreements by the respective government institutions in developing countries. With respect of contracts concluded in the hotel industry the most common difficulties are further exacerbated by greater complexity of compensation problems when compared to those of the manufacturing sector. Firstly, in a standard composite management agreement there is a variety of services rendered by the managing company (technical assistance, managerial and group services) and various forms of compensation are used accordingly. Secondly, there is little standarization with respect to the forms and levels of remuneration. It is quite interesting to note that even large, well established hotel chains use different forms and levels of payment with their various partners. Under such conditions caution is advised for the evaluating officers when dealing with the remuneration issue in hotel contracts submitted for registration because the accumulated remittances to the managing company may be a substantial burden for the remitting country. Prior to carefully considering the level of payments, the registry should investigate if there is a background history for some forms of remuneration which may be specified in the contract. Special attention ought to be given to possibilities of overlapping or double payments for the services rendered by the managing company.

It must however be pointed out that the complexity of the remuneration issue also negatively affects the bargaining position of the owner during the negotiation stage. In fact the owner may not be aware of the accumulated financial consequences of the various contractual provisions or the actual distribution of total gains resulting from the hotel's operation between the managing company and himself. The registry will therefore be expected to provide advisory assistance to local partners in addition to the standard registration procedure.

2. Remuneration for managerial services

2.1 The following forms of remuneration for management services are most commonly used in the international hotel industry:

a. basic management fee
b. incentive fee
c. combination of a and b

As can be seen in Table 2, all existing options were found in the sample contracts. It seems however that the combination of basic and incentive fees are the most commonly ones used in the hotel sector. In addition, the compensation of key expatriate staff seconded by the managing company to the hotel may be considered as remuneration for managerial services. As has been discussed in the previous Chapter, many contracts contained specific provisions on employment and compensation of key staff.

The basic management fee paid by the owner to the managing company reflects the compensation for managing the property, chain identification and access to the group benefits. Conceptually it resembles the payment for use of property rights and know-how in a standard licensing agreement, but usually the basic management fee is expressed in the contract as a fixed annual amount (lump-sum) or as a percentage of the gross revenue. In the latter case the fees were often differentiated depending on the type of revenue (room sales, food sales, beverage sales) and/or the occupancy rate (see examples in Table 2).

From what has been said before it can be concluded that the basic management fee also reflects the return for group services and benefits provided to the hotel. Under such circumstances the additional payment for group services can be interpreted by the registry as a duplication of compensation for the same services. The matter will be discussed in more detail in para. 3.

Table 2

Basic management and incentive fees in the sample of 17 hotel management agreements

No.	Basic management fee	Incentive fee
1.	percentage of gross revenues derived from: room sales - six per cent beverage sales - five per cent food sales - two per cent	none
2.	3 per cent of gross revenue	percentage of G.O.P.[a/] as specified below: 1st year - 7 per cent, 2nd year - 8 per cent, 3rd year - 9 per cent, 4th and after - 10 per cent
3.	2 per cent of gross revenues	5 per cent of G.O.P.
4.	3 per cent of gross revenues	3 per cent of G.O.P.
5.	None	3.5 per cent of G.O.P.
6.	2 per cent of gross revenues	25 per cent of G.O.P.
7.	3 per cent of gross revenues	5 per cent of G.O.P.
8.	US$[b/]300,000 annually	5 per cent of G.O.P.
9.	US$600,000 annually	3 per cent of G.O.P.

Table 2 (continued)

10.	US$250,000 annually	up to US$1.5 - 10 per cent of G.O.P. above US$1.5 - 5 per cent of G.O.P.
11.	US$150,000 annually	none
12.	None	25 per cent of G.O.P. but minimum US$400,000
13.	US$300,000 annually	5 per cent of G.O.P.
14.	None	10 per cent of G.O.P.
15.	8 per cent of gross revenue	none
16.	5 per cent of total income	10 per cent of G.O.P.
17.	2.5 per cent - 7 per cent of net sales depending on the occupancy rate	none

a/ G.O.P. = Gross operating Profit

b/ Typically the lump-sum fees are expressed in the local currency and they are translated into US$ for facilitating comparisons. In most cases the lump-sum fees are indexed against the rate of inflation prevailing in a given country.

The incentive fee reflects the managing company's return for actual use of its resources by a given hotel. Since the use of such resources contributes to the increased profitability of the hotel's operation the incentive fee is usually expressed as a percentage of the gross operating profit (G.O.P.). In addition the maximum or minimum payments are often defined. The incentive fee is meant to motivate the managing company to maximize the profit potential of the property.

2.2 Tentative analysis of the level of payments for managerial services

As can be seen in Table 2, there is no clear trend in the use method for calculation and level of basic management and incentive fees in the composite management agreements surveyed. Although certain chains attempted to apply universal types and fee levels, they were substantially modified during the course of negotiations. Other hotel chains seemed to define the levels of payments individually with each partner without establishing generally applied rates within the chain.

The lack of widely accepted remuneration formulas in the composite chain management agreements creates substantial problems during the negotiation of such agreements as well as evaluation by the registries. On the other hand the existing substantial differences as to the fee types and levels indicated that tough negotiating by the owner and persistent efforts by the registry may bring positive results to decreasing the overall financial obligations to the managing company. From what has been said so far, it is clear that for the time being no simple yardstick for accepting or rejecting specific fee levels in the composite chain management agreements can be offered. It is suggested however that the profit sharing concept developed by UNIDO be applied to such contracts. The details of this method are discussed in the following section. It is pointed out however that the basic fees found in the sample normally ranged between 2 per cent and 5 per cent of gross revenues and the incentive fees exceeded 10 per cent of gross operating profit (G.O.P.) only in rare cases . In cases where both types of fee were applied simultaneously, the fee levels of 2 per cent (basic) and 5 per cent (incentive) seemed reasonable from the owner's point of view.

As has been mentioned before the remuneration of key expatriate personnel could be seen as an additional form of compensation to the foreign partner for managerial services. This question should not be overlooked as the respective amounts reflecting the salaries of expatriates, bonuses, etc. may easily exceed the value of the management fees. The agreements surveyed as a rule contained separate clauses on the remuneration of expatriate staff, remittances of payments abroad, etc. In most cases they were stipulated in order to protect the rights of the managing company regarding the setting of salary levels and remittances abroad. However, clauses protecting the owner's interests were also found in some agreements. This was reflected in the contract by defining the levels of salaries for key expatriates or by setting upper ceilings for these salaries. It seems however that the most convenient and flexible formula for protecting the owner's interests is an explicit proviso stating the right of the latter to approve salary levels of key expatriates.

It can reasonably be assumed that during the course of payment evaluation the registry may count on the owner's cooperation as he would presumably also be interested in decreasing the level of remuneration to the managing company. Thus the registry may request additional information on the projected profitability of the whole venture. Such an analysis of the project is usually made prior to the construction of the hotel. Additional calculations may be done (with the owner's cooperation) while taking different fee levels. If the projected return on the owner's equity is too low compared to the industry's standards then this can serve as a strong argument for decreasing management fees.

It quite often happens however that the actual results fall behind the projected ones and do not ensure an adequate return on the owner's investment. In view of this, the registry may suggest introducing a special "safeguard" clause which may read as follows:

> "In the event that in any year the net profit is not adequate to ensure an X per cent return on the owner's investment (including any loan capital), the managing company 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".

While evaluating the fee levels concluded with international hotel chains the registry could look into the standard levels of payments in similar agreements in the local hotel industry for comparative purposes. For example, the empirical analysis conducted by the registry of Nigeria revealed that the fees applied in the management agreements with local companies were generally lower than those requested by international hotel chains.

2.3 Basic fees applied in contracts other than composite chain management agreements

The sample contracts surveyed contained only one leasing and one franchise agreement so that no general conclusions could be drawn on the payment forms and levels for such contractual arrangements. In the leasing contract the foreign partner paid 66 and two thirds per cent of G.O.P. to the owner and after completing the extension of the hotel paid 72 and one half per cent of G.O.P. This confirms the previously mentioned pattern of leasing arrangement payments to the owner ranging from 60 to 80 per cent of G.O.P.

As for the franchise agreement, the basic fee accounted for 4 per cent or 5 and a half per cent of gross room sales depending on the occupancy rate. Regardless of the aforesaid, the owner paid to the franchisor a minimum amount of US$200,000. There was no big difference between the latter case and the fees applied in composite management agreements. This may be explained by the similar scope of involvement of the foreign partner under composite management and franchise agreements.

3. Payments for group services and benefits

Concerning compensation for group services and benefits there is a fundamental question as to whether such services should be remunerated at all. One can argue that once their use contributes to the increase of turnover and profits, the managing company already benefits from it in the form of increased value of management and incentive fees.

The simultaneous application of the basic management fee and remuneration for group services can be challenged due to their obvious overlapping.

The results of the empirical survey revealed differentiated approaches to compensation for group services. The following points may be mentioned:

- clear provision that group services should not be compensated separately. This was found in one contract only and the respective clause reads as follows:

  "Neither the managing company nor any affiliate of the managing company shall receive any fee or profit for the rendering of group services and benefits in addition to the basic management fee",

- nothing was mentioned on the remuneration for group services. This was evident from agreements concluded with smaller, less known chains where the effect of rendering group services was minimal;

- the principle of remunerating group services at cost. Such a concept is usually strengthened by a clause stating that neither the managing company nor its subsidiary shall receive any profit for rendering group services. In the case of leading chains a reference is made to the standard methods of calculation and allocation of cost for group services.

- the universally applied fees for the various kinds of group services are precisely defined in the contracts. It was found that two leading international hotel chains tend to apply unified fees for group services throughout the system. These were advertising, reservations, sales services, trademarks, licence fees, etc. They were expressed as a percentage of revenues or as a fixed amount per room.

It seems that the question of compensation for group services requires special attention by a registry as the potential benefits resulting from its intervention could be substantial. In the first place the registry could challenge such payments while using the arguments given above. Alternatively, payments for group services could be linked to the basic management fee and the reduction of the latter may be suggested. While following a more flexible attitude the registry might accept the cost principle for remunerating group services. If so, the registry should insist on the precise definition of the methods for calculating and allocating the cost of rendering such services in order to avoid excessive payments and duplications. (The negative examples of typical provisions are given in the next paragraph).

The remuneration for use of trademarks, trade names, signs, etc. should attract the special attention of the registry. In the previous chapter it was pointed out that the standard trademark licence should not be accepted within the "package" of the composite chain management agreement. Consequently payment in the form of a trademark license fee should not be approved either. It was found however that some kind of trademark fee was applied without the granting of a license. A leading hotel chain charged a fixed lump-sum fee for the use of each outdoor script or great sign. It is recommended that the respective clauses relating to such payments be also eliminated from the agreements submitted for registration.

4. Compensation for additional services rendered by the managing company

4.1 Reimbursement of pre-opening expenses

Under normal circustances the managing company assumes its responsibility several months prior to the official opening date of the hotel in order to supervise and coordinate preparatory activities. The generally accepted practice in the hotel industry is that the services at the pre-opening stage are provided at cost, to be reimbursed by the owner. Such expenditures are usually subject to amortization over five years, for example after the first year of operation of the hotel. The

contracts surveyed varied substantially with respect to determining pre-opening expenses. Some contracts left full discretion to the managing company in that area. The overwhelming majority of agreements surveyed imposed the obligation upon the managing company to prepare an advanced budget for the pre-opening programme to be approved by the owner.

It has to be emphasized that the pre-opening expenses represent a heavy burden to the owner during the first period of the hotel's operation. It is not unusual to find that the total pre-going expenses (i.e. after construction but before opening) amount to US$2 million. The full discretion of the managing company in determining such expenses may lead to excessive payments as the managing company could consider the pre-opening budget as a kind of "down payment" for managerial services. Under such circumstances the registry should insist on the inclusion of provisions explicitly stating the obligation of the managing company to prepare a detailed pre-opening budget subject to final approval by the owner. As a rule such a budget should be attached to the agreement submitted for registration.

4.2 Compensation for technical assistance services

The general principle, widely accepted in the hotel industry, is that additional services rendered during the pre-operational and operational phases by the managing company or its subsidiaries and affiliates, shall be reimbursed at cost. Unfortunately, similar problems to those discussed in the previous paragraph are associated with determining the cost of such services. This calls for special attention by the registry in that area while evaluating the agreement. The type of formulations to be avoided and which are found in the contracts surveyed are:

- a straightforward expression of the technical service fee as a "down payment", e.g.

"In consideration of the execution of this agreement, the owner agrees to pay to the MC a commitment fee to 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 the MC (during the 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.";

- a flat fee for technical services determined by the managing company, e.g.:

"The MC shall make available to the owner its technical assistance services, and the owner shall pay to the MC the sum of X US dollars, representing minor sundry costs based on the managing company's experience in providing the said services";

- provisions allowing for the inclusion of overhead and administrative expenses;

- provisions which allow the managing company to charge overhead and administrative expenses, e.g.:

"The payment to the managing company shall be made as follows:

(a) reimbursement of payroll costs, plus

(b) which is 150 per cent of (a) to cover general and incidental expenses, and

(c) reimbursement of all direct expenses relating to such services".

During the evaluation process the registry may suggest modification of the respective clauses in such a way that the cost principle is strictly applied when determining the compensation for technical services, subject to final approval by the owner.

As has been mentioned in the previous chapter, the provisions covering additional purchasing services rendered by the managing company to the chain members were found in the example. In the case of one international chain the managing company, acting as a purchasing agent charged 6 per cent of the value of the relevant sales invoices. In addition the owner settled all direct expenses incurred by the managing company while providing such services.

Following the recommendation offered in the previous chapter the registry should aim at eliminating all clauses relating to payments for the purchasing services from the main body of the contract in order to avoid misinterpretation as to the voluntary versus obligatory character of such services.

5. Application of the income-sharing concept to composite management contracts in the hotel industry

In this section we shall investigate whether the income-sharing concept can be used as an analytical tool for evaluating payments in composite management agreements in the hotel industry. The experience accumulated by technology transfer registries participating in the TIES system provided the background for UNIDO to develop the methodological concepts of evaluating payments for acquired technology. This concept, often referred to as the UNIDO method, basically views the payments for technology as an "income-sharing device" between the transferor and transferee. It was originally designed for evaluating straight licensing agreements and was later modified in order to incorporate equity participation of the transferor.[10/]

Although a composite chain management agreement differs substantially from the licensing or joint venture contract, it may be argued that with a slight refinement the income-sharing concept could be applied to the former arrangement as well. For that purpose we shall replace the basic formula of LSIP (Licensor's Share in Intrinsic Profit) by the concept of Manager's Share in Intrinsic Profit (MSIP).

Let us define first the "remuneration package" (R) of the chain management agreement (M). It consists of the following elements:

(1) basic management fee - B
(2) incentive fee - I, and
(3) salaries of key expatriate staff seconded by the managing company to the Hotel - S

$$R_{CM} = B + I + S_{EX}$$

Depending on the scope of "basic" services and payment formula adopted in a given contract only some elements of the package may be applicable.

The idea of Intrinsic Profit when applied to chain management agreements requires further clarification. Like the royalties in the straight licensing agreements, the basic management fee and salaries of expatriates are charged to the cost of operation, thus constituting the "hidden" part of the profit. As for the incentive fee, it is the result of sharing the Gross Operating Profit (GOP) between the managing company and the owner. Taking into account that the GOP concept is widely used in the hotel industry we should rather speak of Intrinsic Gross Operating Profit. ($IGOP_{CM}$). As a result we arrive at the following expression:

$$IGOP_{CM} = B + S_{EX} + GOP$$

Finally the $MSIP_{CM}$ concept can be defined:

$$MSIP_{CM} = \frac{B + I + S_{EX}}{B + S_{EX} + GOP}$$

For the sake of demonstration we shall use data from the illustrative income statement given in the WTO study with some additional assumptions as to the salary level of expatriate staff. 11/ The respective figures are the following in thousands of US$:

GOP - 1037
B - 215
I - 207
S_{EX} - 60

We arrive at the following $MSIP_{CM}$ coefficient:

$$MSIP_{CM} = \frac{215 + 207 + 60}{215 + 60 + 1037} = \frac{482}{1312} = 37 \text{ per cent}$$

Obviously the above concept must be tested when confronted with the real data in the registries in order to identify all problems and modalities when applying it for the purpose of evaluating chain management agreements. It should be remembered that generally the ISIP concept is of little use when applied to inter-sectoral comparisons. It may be useful however when comparing various fee structures and fee levels requested by leading hotel chains in relation also to the standards adopted by the local hotel industry.

6. Other matters related to payments

6.1 Use of standard accounting methods

As the various fees paid to the managing company are usually calculated as a percentage of profits and/or revenues the accounting methods used have a direct impact on the actual value of payments to be made. In the hotel industry a substantial degree of standarization of accounting methods exists. The system adopted by the American Hotel and Method Association known as the "Uniform System of Accounts for Hotels" is widely accepted throughout the world. The use of internationally accepted methods has obvious advantages for partners from developing countries. However in some cases these may not comply with the laws and regulations of the recipient country. The registry shall therefore make sure that the reference to the Uniform System of Accounts for Hotels is amended by the following statement:

> " ... but in all cases in accordance with local laws and regulations".

The empirical analysis revealed that in the case of one leading transnational hotel chain the financial calculations were based on standard accounting principles adopted and uniformly applied by a given

chain. If possible the references to the international accounting standards should be avoided as this gives the managing company a strong bargaining position in possible future disputes.

6.2 Clauses on foreign remittances

A great number of contracts surveyed contained various clauses on the reimbursement by the managing company to be effected in a foreign currency. In some cases the fees and royalties were expressed in a foreign currency. More often the owner was required to deposit relevant payments to the managing company's bank account abroad. He was also obliged to cooperate with the managing company in obtaining permits from the local authorities for remitting fees, royalties and salaries abroad. Obviously such clauses protect the interests of the managing company, especially in countries with strict currency regulations.

In the course of contract evaluation the registry should consider two aspects of the above question. Firstly, certain far-reaching clauses on foreign remittances may directly violate existing laws and regulations in the recipient country. Such clauses should definitely be eliminated. In any case, reference to the specific legal acts pertaining to the currency controls should be included in the contract.

Secondly, the registry should carefully review the respective clauses in order to eliminate excessive currency remittances.

Often, the respective contract clauses authorize the managing company to be reimbursed in a foreign currency for technical services and salaries of expatriate personnel irrespective of the fact that only a fraction of the cost was incurred in a foreign currency. In such cases the registry could apply the previously discussed cost principle to such payments, i.e. allow the remittance of the fraction of cost effectively incurred abroad.

V. DURATION AND EXTENSION OF MANAGEMENT AGREEMENTS IN THE HOTEL INDUSTRY

1. Introductory remarks

In the process of evaluating and registering technology transfer agreements, the registries usually attempt to establish the length of time necessary for the effective assimilation of technology by the local partners. In the course of contract evaluation there is a clear tendency towards limiting the duration of contracts because unduly long contracts result in unnecessary payments to the foreign partner.

While considering the duration of contracts in the hotel industry two additional factors should be taken into consideration. Firstly, in respect of the newly built hotels, on the average an initial period of at least eight to ten years is required to recover start-up costs and establish the market position of a given hotel. Secondly, the benefits for the owner as well as recipient country result not only from one-shot transmission of experience and know-how, but also from the lasting participation of a given hotel in the well-established international chain. The above factors call for a different approach to the length of contractual arrangements used in the hotel industry as compared to those of the manufacturing sector.

2. Results of the empirical survey

The majority of contracts surveyed stipulated the initial term of contract at 10 or 15 years. Only in one agreement had the initial duration been set at 20 years. Examples of durations of less than 10 years were also found. However the analysis of contractual clauses defining the conditions for extending the term revealed that the managing company was usually granted the right of automatic extension of the period for another 5-20 years. Such a right was limited only by default of the terms and conditions of the initial agreement. In practical terms the owner was usually bound to his contractual partner for at least 25-30 years.

3. Recommended approach by registries

Since a long-term relationship is in the best interests of the hotel owner as well as the recipient country, the principles adopted by the technology transfer registries as to the duration of technology transfer agreements should be applied to the hotel sector in a very flexible manner. Generally, an initial period of 10 or even 15 years may be permitted by the registry. Major emphasis should however be laid on the clear definition of the right of the local partner to modify the conditions of the agreement after the initial period. This might be achieved in the first place by the requirement of a mutual agreement by both partners for a contract extension. On the other hand, provisions stipulating on automatic extension of the contract should be avoided or substituted by clauses which call for a review of contract conditions upon completion of the initial term.

Footnotes

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

2/ The recommendation has been made by the Seventh Meeting of Heads of Technology Transfer Registries, UNIDO, New Delhi, 7-10 December 1982

3/ See J. Cieslik, "Contractual Arrangements for the Transfer of Technology in the Hotel Industry", UNIDO, ID/WG.405/1, Vienna, 1983

4/ For the sake of simplicity the name "Registry" is used throughout the text.

5/ For that purpose the recent UNCTC study can be useful. See UN Centre on Transnational Corporations "Management Contracts in Developing Countries: An Analysis of Their Substantive Provisions" ST/CTC/27, United Nations, New York, 1983

6/ See "Transnational Corporations in International Tourism", UN Centre on Transnational Corporations, ST/CTC/18, United Nations, New York, 1982, p. 28

7/ This section draws on WTO, "Accommodation Management Methods: The Management Contract", PG/II/1.3.2.B/1, Madrid 1980, p. 2-8.

8/ The brief characteristics of the services provided by the foreign partner will be given in the next chapter.

9/ Under typical arrangement the expatriate staff are designated temporarily to operate a hotel abroad while remaining on the payroll of the managing company, especially in those countries with strict exchange controls.

10/ The most up-to-date version of the profit-sharing concept can be found in V. R. S. Arni, "Evaluation of Technology Payments", ID/WG.429/5, UNIDO, Vienna, 1984

11/ See WTO, "Accommodation of ...", op. cit., Appendix A. We made an assumption that the salaries and bonusses of the expatriate personnel amounted to US$60,000.

10/ The most up-to-date version of the profit-sharing concept can be found in V.R.S. Arni, "Evaluation of Technology Payments", ID/WG.429/5, UNIDO, Vienna, 1984

11/ See WTO, "Accommodation of ... ", op. cit., Appendix A. We made an assumption that the salaries and bonusses of the expatriate personnel amounted to US$60,000.