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Abstract of thesis entitled ‘Growth of China’s Hotel Chains and Their Future Expansion’ submitted by Qi Pingshu for the degree of Master of Philosophy at The Hong Kong Polytechnic University in June 2002.

Since the rise of professionally managed, multi-unit organization hotel chains in this century (Ingram, 1996), the world hotel industry is dominated by hotel chains with more and more hotels affiliated in some way with a chain operation (Pine, 1998). As a result of China’s economy reform and opening up, China’s hotel industry experienced dramatic changes, especially with the involvement of multinational hotel companies (MNHCS) and their introduction of the concept of chain operation. The influx of massive inbound tourist numbers and technology transfer enabled the development of indigenous hotel management companies and the formation of local hotel chains. However, after decades of development, local hotel chains are still very slow in expansion and much less competitive than multinational hotel management companies. How indigenous hotel chains will develop has become a major concern in the hotel industry.

This research aims to examine the development of hotel chains in China since 1978 and to make policy and operation recommendations for further expansion of hotel chains. It first explores and describes the historical and current situation of hotel chain development in China, and then a model of hotel chain formation is built to further examine the development of chain operation in the general hotel industry. The proposed model is based on the two parties in the process of hotel chain formation - hotel management companies and independent hotels. The model

identifies and examines the major factors for both parties and how these factors interact during the course of chain formation. Domains of this model are identified as: external pressure, internal pressure, environmental scan, organizational capability, assessment of availability, form of alliance, and management/operation. Through the application of this model in China, certain opportunities are identified to discuss the necessity for and the viability of indigenous hotel chain development. Major issues and barriers in the process of hotel chain formation and expansion are also identified. Possible measures and strategic issues were further explored, which would assist in the future development of hotel chains specifically, and the hotel industry at large in China.

This research uses qualitative and case study methods to investigate the existing situation of the hotel industry and hotel chain operation, and to examine the model of hotel chain formation in China. In-depth interviews with 26 hotel managers and industry experts were conducted by using closed and open-ended questions relating to hotel chains and independent hotels in the process of chain formation and expansion.

It is revealed that the increasing external and internal pressures are driving the hotel industry towards a certain degree of consolidation and restructuring. The changes in the hotel industry in recent years (e.g. overprovision of hotels, structural changes in the industry, rise of domestic tourism, great demand for economy and budget hotels, and creation of new resort and motel sectors) provide potential and productive opportunities for chain expansion. However, the growth of indigenous hotel chains

was constrained by both the complicated business environment in the country and the inadequate management capability of the hotel management companies.

As China is in a transition period from the previous planned economy to a market economy, it still lacks the essential market principles and relevant rules, legislation and mechanisms of a market economy. Further reform of the economic system in China and the establishment of a competitive mechanism are recommended to create a better business environment for chain operation. These should cover reform of state-owned hotels, ease restrictions on the free flow of hotel assets, allow rationalization of legislation and regulations, decrease government intervention and provide more incentive policies for hotel chain growth.

The development of organizational capability of hotel management companies is an urgent need for the expansion of hotel chains. More business acumen and adaptability should be exploited to get essential financial, human and other resources, and integrate these resources into productivity and services for Chinese hotel chains. The development of organizational capability of hotel management companies will focus on the standardization of management models, creation of distribution channels and networks, and branding of hotel products and establishing supporting systems. The management competence of the indigenous hotel companies should be upgraded to an international standard, whilst keeping adaptability and flexibility in the special Chinese circumstances.

Key words: Hotel Chains, Growth, China

**GROWTH OF CHINA'S HOTEL CHAINS AND
THEIR FUTURE EXPANSION**

SUBMITTED BY

QI PINGSHU

**FOR THE DEGREE OF
MASTER OF PHILOSOPHY**

THE HONG KONG POLYTECHNIC UNIVERSITY

2002



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DEDICATION

This thesis is dedicated to my family.

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Chapter 1 Introduction

1.1 The Hotel industry and hotel chains in China

1.1.1 Development of China's tourism and hotel industry

After 20 years of endeavor in tourism development, China has become the world's seventh tourist destination in terms of foreign tourist receipts of US\$ 14.099 billion, and tourist arrivals of 27.0466 million (WTO, 2000). Catering to the rapid growth of travelers, China's hotel industry kept pace with tourism development. According to the China National Tourism Administration (CNTA), from 1978 to 1999, hotels in China increased from merely 203 to 7035, an annual increase rate of 18.22 %, which might be one of the fastest growing hotel industries in the world in the same period. In 1999 China had 7035 hotels with 889,430 rooms, 1,769,825 beds and fixed assets of RMB 236.94 billion (US\$28.65 billion), generating revenue of RMB 84.57 billion or US\$10.23 billion. The hotel sector was an important foreign exchange earner in the tourism industry. In 1999 the tourism receipts from the hotel sector accounted for 14.4% of the total (CNTA, 2000).

1.1.2 Entry of multinational hotel companies

During the course of hotel development in China, one of the most important steps was the introduction of foreign participation, which radically changed China's hotel industry, bringing in not only investment to ease hotel shortage, but also the advanced management techniques, technology and the international practice to break through China's old conventions (EIU, 1989). The first hotel management company to operate a joint-venture hotel in China was the Hong Kong based Peninsula Group

(Yuan, 1998). Since then, 43 hotel groups, management companies, investment and trading firms, or similar organizations from 21 countries or regions have entered China to run hotels (EIU, 1989). Major multinational hotel companies e.g. Holiday Inn, Sheraton, Hilton, Accor, Shangri-la operated more than 200 hotels in China (Wei, 1994). Bass Hotels & Resorts is the largest hotel chain in China, operating 26 hotels in 2000 (in July 2001, Bass Hotels & Resorts changed its name to Six Continents Hotels). Shangri-la has 15 hotels in China. Marriott International managed 15 hotels in China. Starwood Hotels & Resorts operated 10 hotels; Zenith hotels International Inc, 10 hotels; and Nikko Hotels International 4 hotels (Shellum & Lui, 2000).

1.1.3 Hotel chain operation in China

Though entry into China was part of the geographic expansion strategies of the international hotel chains, the concept and practice of chain operation imported to China by the international hotel companies greatly changed the thinking of China's hotel industry. After decades of western management and adaptation to the Chinese market, technology transfer (Pine, 1991) enabled the Chinese hotel industry to establish local hotel management companies. In 1988 the first Chinese hotel management company - the White Swan Hotel Management Company - emerged in Guangzhou to try to exploit the local hotel management market and develop Chinese hotel chains (Yuan, 1998). Since then, 39 hotel management companies were initiated in China, which operated about 100 hotels nationwide (table 1).

However, in terms of the whole hotel market, the industry is still dominated by independent hotels, with only 16% of hotels chain-operated (Li & Feng, 1997).

While in the US, it was estimated that 64% of hotel rooms were affiliated with hotel chains in 1986 (Leonard, 1987). Among the Chinese chain hotels, especially the luxury and high-class hotels, most are operated by multinational hotel management companies (MNHCS), as most of these hotels are joint venture hotels invested by foreign companies.

After 20 years of development, China's hotel market is a very complicated scenario and a blend of all kinds of models in terms of ownership, management, affiliation, and structure. Intense investment in the hotel sector has caused room supply to outpace tourist increase. This over-capacity has resulted in a drop of operating profit and room rate (table 2).

The problems of overprovision of hotel rooms, fierce competition, multiform ownership and management systems, and imbalance of geographic distribution have emerged in China's hotel industry (Zhao, 1989; Zhang, 1989; Yu, 1992). Heavy reliance on foreign hotel management companies causes leakage of profit and increases costs of hotel operation and contributed to external debt burden (EIU, 1989).

As the economic reform carries on toward a market oriented economy system and hotel development continues, the fragmented hotel sector in China enters a phase of re-organization, diversification and rationalization. The whole industry is inevitably led in a direction toward concentration, consolidation and optimization for further development.

There has been a major concern in the hotel industry about expanding, or rather creating China's indigenous hotel chains, through which to get more market share from China's booming hotel management market, benefit from the potential domestic and outbound travel, and improve the performance and the competitiveness of Chinese hotels by this kind of reorganization.

1.2 Problem statement

After 20 years' reform and opening up, China's economy has changed a lot from the previous soviet-style philosophy towards a market-oriented economy, the whole national economy is transforming to a modern enterprise system and restructuring for better performance (Chai, 1998). Establishing group enterprises or conglomerates to compete in the world market has been tried and adopted as a national strategy for China's further economic development (Li, 1995). In the hotel industry, a similar transformation and restructuring was also experimented to integrate hotels into hotel chains or hotel groups to improve the competitiveness and performance of Chinese hotels in the local market, and maybe the world market in the future. However, since the emergence of the first hotel management company a decade ago, hotel chain development in China is still far below the expectation of the industry.

Whether the formation and expansion of hotel chains is a choice for the Chinese hotel industry to fulfill the great potential, get more market share and benefit from China's future tourism development becomes a critical issue in China's hotel industry. It is forecasted by the World Tourism Organization (1999) that China will be the world's largest tourist destination with 130.0 million arrivals and the fourth source country of 100.0 million outbound tourists in the year 2020. According to

CNTA, in the year 2010 Chinese domestic tourism will produce 2 - 2.5 billion travelers, generating tourist revenue of RMB 1000 - 1050 billion (CNTA, 1995). In addition, more people in China traveling abroad could lead to massive tourism leakage. Expanding Chinese hotels in a foreign country, mainly for use of Chinese people, is one way to counteract this possibility (Pine, 1998).

In past studies e.g. Zhu (1995), Zhang (1992), Yang (1991), more focus has been placed on the urgency of hotel chain development in China, but little has been done on the actual viability and feasibility of chain formation within China, especially in a world economic system of globalization and economy integration, where the multinational hotel companies stretch to every possible corner of the world market. China was a key destination for many international hotel companies during the last decade. As a result, competition became fiercer not only between Chinese and foreign hotel companies, but also among those international hotel chains in the Chinese market. International hotel chains expanding to China enjoyed the advantages of management, marketing, technology, worldwide reservation system and easier access to the source markets, which put local Chinese hotel companies in an unfavorable position. Moreover, most hotel companies in China were small in scale and lacking resources and knowledge to develop their organizational capability for expansion. In addition, a great separation between hotels for domestic travelers and international tourists also created a gap for Chinese hotel companies to expand to the high-class hotels, which were dominated by international hotel management companies.

Past studies attribute the slow growth and failure of the Chinese hotel chains mainly to the business environment and the particular aspects of the Chinese political, economic and social systems, for instance, the government-owned property rights of hotels, and protectionism of the local authority (Du & Dai, 1998; Zou, 1998; Wang, 1998). However, these researchers concentrated mainly on macro level problems, little has been done at a micro level about motivations and behaviors of hotel management companies and independent hotels. A more in-depth survey beyond the business environment issues is needed to reach a more detailed explanation of the actual process of hotel chain formation and expansion, which concerns two parties - the hotel management company and individual hotels - and their respective organization behavior in the given business environment in China. Investigation of the problems and factors that influence hotel management companies and individual hotels in the process of hotel chain formation, and the relationship between these factors will assist both parties to understand the situations of their own and their counterparts during the course of chain formation, and tune toward a mutually beneficial direction.

Even if it is assumed that the Chinese hotel industry should be directed towards consolidation, it is not clear what kind of reform should be undertaken to produce policy guidelines to improve the business environment, and which sort of strategies should be formulated for chain operation in the hotel industry. Usual approaches of chain formation e.g. acquisition/merger, franchising, management contract, and related strategies (e.g. branding, segmentation), should be examined to check whether they would work well in a Chinese environment. Pine (1998) pointed out that due to the complexity of the political, cultural, economic, financial, and

environmental systems in China, the creation of affiliations there needed to be especially careful not to simply assume that formats used in other parts of the world would be successful in China. Based on an examination of the issues of both hotel chains and the independent hotels, it is noteworthy to identify specifically which type of affiliation(s) and what kind of strategy would be most appropriate in China.

Key questions:

1. Is the formation and expansion of hotel chains an option for the Chinese hotel industry to fulfill the great potential, get more market share and benefit from China's future tourism development?
2. What are the underlying attributes and problems that influence hotel management companies and individual hotels in the process of hotel chain formation in China and what is the relationship between these factors?
3. What kind of regulation reform should be undertaken to produce policy guidelines to improve the business environment, and which sort of strategies should be formulated for chain operation?

1.3 Aim & Objectives

1.3.1 Aim

This research aims to examine the development of hotel chains in China since 1978 and to recommend possible guidelines for further expansion of hotel chains.

1.3.2 Objectives

1. To explain the historical context in which hotels have developed in China
(Including national policies on hotels, tourism and economy);

2. To describe and evaluate the current hotel industry in China;
3. To investigate the existing situation of chain-operation in China's hotel industry
(Including creation/formation and development of hotel chain in China);
4. To assess the necessity and the viability of indigenous hotel chain development in China (Including identification of major environment and management issues and major barriers concerning hotel chain development and expansion in China);
5. To develop a model of hotel chains development and apply it to examine the hotel chain development in a China context;
6. To recommend possible measures to assist in Chinese hotel chain development.

1.4 Significance of this research

1.4.1 Potential contribution to the hotel industry

Chain operation is an important business form in the international hotel industry, and has developed very quickly, especially in recent years, when globalization and consolidation have greatly changed the structure of the industry. However, as a developing market, the hotel industry in China is not heavily concentrated or controlled by several large companies, but dominated by independent hotels, most of which are low efficiency state-owned properties. It is unclear within the Chinese hotel industry whether it is necessary to create hotel chains; and if necessary, how hotel chains can be formed to improve the industry at large for future development. This research will explore the nature and rationale of chain formation and operation in the Chinese hotel industry context, which can enable hotels in China to determine appropriate directions and strategies. During the course of hotel chain formation, there are various stakeholders, including independent hotels, hotel management

companies and regulators. For various independent hotels, this research will examine the stances of independent hotels in a fiercely competitive environment and how they should position themselves in the market (whether to remain independent or go into affiliation with a chain) and considerations should be taken for chain formation. For hotel management companies, which are generally at a primitive stage in China, this research will explore the feasibility of further chain formation and expansion based on the existing resources and capabilities of current hotel companies, and try to find out the major issues for their conglomeration and possible approaches to improve performance. Generally, the research will explore the driving forces for hotel chain formation, the type of chain formation, the patterns of alliance and the strategies in expansion, which will give the industry better insights to choose appropriate approaches and strategies for their own hotel development. As China is traditionally a heavily regulated economy, how government agencies can better regulate the hotel industry and improve the competitiveness of the indigenous hotel companies will be critical to the further development of the hotel sector in China. Examination of the current legislation, regulation and policies will facilitate possible reform in the hotel industry.

1.4.2 Academic significance

The rise of hotel chains has radically changed the hotel industry, and the existing multinational expansion gradually became the mainstream of the industry. However, all this has only taken place in several industrialized countries. As the world tourism industry becomes more dynamic and diversified, especially the emergence of more and more new tourist destinations, the hotel industry in these areas begins to take off. But most hotels in the new tourist destinations are controlled by MNHCs, which

causes leakage of tourism revenue from the destination countries. Till now, little research has been done on the indigenous hotel chain development in these receiving destinations. This research identifies two kinds of organizations in the current Chinese hotel market, which are independent hotels and hotel management companies, and develops a model of hotel chain formation based on the steps taken by the two kinds of organizations. Relevant domains are defined as internal pressure and external pressure, environment scan, organization capability, assessment of possible partners, form of alliance and the resulting management/operation issues. The primary contribution to knowledge of this research will be to address the following questions:

- (1) How internal and external pressures in the market influence hotel organizations and their future strategy?
- (2) Through environmental scan, what are major environmental issues that hotel management companies should take into consideration during the course of hotel chain formation?
- (3) What constitutes the organizational capability of a hotel management company and how to attain it?
- (4) What factors do two parties use to assess each other during the course of possible chain formation?
- (5) What are the different types of hotel chain formation and their adaptation in the Chinese market?
- (6) What major management and operation issues arise after the chain affiliation, especially in the given environment for Chinese hotels?

Generally this research will contribute to the theory and practice of hotel chain development, especially in newly developing destinations such as China, by exploring chain formation and expansion in the particular political, economic, social, cultural environment of a developing country. In the mean time, this may also have some implications on multinational hotel companies for their future operation in a different business environment.

1.5 Definition of terms

Hotel chain

Two or more hotel properties that are owned or managed by one company (Dervaes, 1990, pp.81).

Hotel

An establishment providing accommodation, food and drink for reward mainly to travelers and temporary residents, usually also meals and refreshments to other users, and often other facilities and services (Medlik, 1993, pp.131).

Hotel industry

Collective term. Most commonly applied to hotels and motels but sometimes also variously extended to include such establishments as guesthouses and boarding houses (Medlik, 1993, pp.131).

Lodging industry

American terms used as a synonym for hotel industry, but also in a wider sense to include to a varying extent all or most other establishments of commercial hospitality, such as guesthouses and also condominium (Medlik, 1993, pp.162).

Multinational Hotel Company (MNHC)

Hotel company covers not only foreign firms with direct investments in a particular host country, but also those firms having all major forms of contractual arrangements and enterprises in host countries (UNCTA, 1982, pp.2)

Chapter 2 Literature Review

2.1 Conceptual Framework

The formation of a hotel chain concerns two parties – hotel management companies and individual hotels, as the hotel management companies played the core role in the course of hotel chain development, this research will start from how hotel management companies grow and expand.

2.1.1 Theory of growth

2.1.1.1 Models of growth developed by Penrose and Marris

In the theory of firm's growth and expansion, Penrose (1995) developed a model through empirical study, which mainly explores the relation among resources, productive opportunities, managerial competencies, firm size and ways of growth and expansion. The economic function of a firm was assumed to be acquiring and organizing human and other resources to supply goods and services to the market profitably. The firm has certain productive resources and the services, which are organized within the administrative framework of the firm to take advantage of the opportunities it faces. Any limit on the rate of growth which can be achieved in a particular period is ascribed to limited productive opportunities, as managers are assumed to wish to expand the firm as fast as possible, taking advantage of all the profitable growth opportunities they see. The market and the resources of the firm limit its growth and expansion. 'Uncertainty' or 'risk' also limits the size of a firm as the expected cost and revenue calculations of firms reflect their expectations about the future course of events. The expansion that existing managers can achieve, and to what rate at which managers can efficiently expand their numbers also

depends on their managerial capacity. Any firm is circumscribed by its resources and by the services it can render. At all times the productive opportunity of a firm is being shaped by the circumstances - internal and external inducements, and internal and external obstacles.

Marris (1998) developed another model for firm's growth, which has three key elements (assumed motivation, a market valuation model and a theory of takeovers) and incorporates two main relationships (the supply of capital function and the costs of growth function). It recognizes and incorporates the internal constraints set by the available management team and its skills but places more emphasis on the external limits to growth posed by the capital market.

Though different models were developed to explain the growth and expansion of firms, generally they consider both the external and internal factors at different stages of development. In the given environment the market provides certain productive opportunities, then the firm can organize a bundle of resources, physical, financial or human, and produce a kind of product or service. Under such an administrative organization, it is motivated to grow, with internal expansion through size, or external expansion through takeover. The major aspects for growth and expansion discussed below are: environment, resource, managerial competence, and networking.

2.1.1.2 Environment

In the development of the theory of growth, the influence of the 'environment' was put on one side in the first instance. The relevant environment - the set of

opportunities for investment and growth that entrepreneurs and managers perceive - is different for every firm and depends on its specific collection of resources. The productive activities of a firm are governed by its 'productive opportunity' (Penrose, 1995), which comprises all of the productive possibilities that entrepreneurs see and can take advantage of. The growth of firms needs the examination of the changing productive opportunity of firms in a given environment. Moreover, environment can also be manipulated by the firm to serve its own purpose.

Environment is the field that hotel chains root in and grow from, though it is often argued that environment is immeasurable and uncertain to analyze, the understanding of environment can still be very important for the growth of a company. The environment factors can be analyzed as the macro external environment and micro task environment (Zhao & Olsen, 1997). External environment covers five aspects: economic, political, technological, socio-cultural, and ecological. The task environment (Dill, 1958) focuses upon forces affecting the industry and its structure, which is given by Porter (1980) as forces from competitors, customers, suppliers, and substitutes.

The emergence and formation of hotel chains is observed in the business environment about how it determines its behavior and interacts with other firms within the ecosystem for further development. In fact the formation of a hotel chain is a mixed interaction of the external environment and the internal capability of the hotel management company and individual hotels. Firms depend on the environmental conditions necessary for the success of their actions, and, more

importantly, they can also change the environment in some degree by their own activities.

Ingram (1996) explained it was difficult to operate a hotel chain in the business environment of the past century. He attributed the success of hotel chains to the changes in the operating environment faced by chains. Mainly these changes were: the supply of professional managers to the hotel industry and the sophistication of control systems; changes in the technical environment especially the accounting and management information systems; changes in transportation methods and travel patterns; and, the emergence of franchising. In some countries the environment still lacks basic driving forces and the necessary resources for hotel chain growth, in others, the complexity of the environment prevents the growth of the hotel management company, which needs further rationalization at the macro level.

On the other side, firms should be sensitive to changes in the environment and take opportunities for growth. Hotel companies should scan the environment to evaluate the firms' intangible assets, the internal strengths and weaknesses within the organization and competitiveness within its task environment (Hall, 1992; Zhao & Olsen, 1997), match the threats and opportunities in that environment with appropriate strategies and then determine how to grow (Knowles, 1996; Olsen, Murthy & Teare, 1994).

The relationship between organizations and their environment centers upon the fact that organizations need to survive. In order to survive, organizations need to adapt to meet the demands of the environment. According to the classic population ecology

theory (Aldrich, 1979), only those organizations that have unique or superior characteristics or that fit environmental conditions can survive and achieve growth.

Strategic management offers an alternative perspective in terms of an organization interacting with the environment. It argues that organizations can help create as well as react to the environment (Summer, 1980). This theory proposes that the environment is not only assessed by the degree of complexity and turbulence but it is composed of a broad range of “constituencies”(Watson, 1986). Each of the constituencies will exert particular demands on organizations for certain outputs. Organizations need to design their own internal resource competencies to meet the external outputs demanded.

2.1.1.3 Resources

A firm is a collection of productive resources in an administrative unit. The growth and size of a firm is best gauged by the productive resources it employs, which include physical resources (equipment, land, natural resources, raw material) and human resources (administrative, financial, legal, technical, and managerial).

In planning an expansion a firm considers two kinds of resources - its inherited resources (e.g. existing management) and those obtained from the outside (e.g. new capital) in order to carry out its production and expansion program. There is a close relation between the various kinds of resources with which a firm works and the development of the ideas, experience, and knowledge of its managers and entrepreneurs. The process of production is an integration of resources and knowledge, with input of resources and the product or services as output. Moreover, the productive services available from resources sometimes can create a new demand

in the market. Market changes, together with the resources and advantages accruing to a firm, create the special productive opportunity of a given firm.

In the hotel industry the resources are both physical and intangible, however, the services the hotel management company renders to hotels are more of a software nature, which means more emphasis on management expertise, know-how, and technical support.

2.1.1.4 Managerial competence

With the evolution of capitalism and the managerial revolution, ownership is separated more from control in the firm and managers make more key decisions in the handling of the firm's resources. Penrose's (1995) analysis suggests that the rate of growth of the firm in any period is limited by the capacity of the existing management and the limitations on the productive opportunity due to conditions internal to the firm. Growth may sometimes be constrained by external demand and supply conditions, but in general internal bottlenecks will make themselves felt first. This analysis places great emphasis on managerial experience within the firm. However, the experience from outside also has great value. In fact, one important factor why independent hotels require a hotel management company is to get access to outside management expertise.

Perrow (1970) argued that barriers to effective managerial practices were derived from two characteristics of situations: complexity and unpredictability. Complexity occurs when the events and issues that managers encounter are multifaceted and the methods used to deal with them are varied. Unpredictability impacts upon the flow

of organizational processes and upon managerial actions and causes uncertainty in managers' lives (Smith et al., 1996). Complexity and unpredictability can be further exacerbated when abrupt environmental changes occur within a country, which are out of the control of individual enterprises. The managerial restraint results in a limit to the productive opportunity of the firm and its rate of expansion.

2.1.1.5 Network

The network concept refers to groups of firms operating closely together and depending on each other through formal contractual arrangements or alliances in an interrelated managerial framework for a variety of services, including technology. D' Cruz and Rugman (1994, pp.276) defined that “ networks are governance structure for organizing exchange through cooperative, non-equity relationships among firms and non-business institutions”, seeing the network as a way of reducing costs in markets and hierarchies. Gomes-Casseres (1944) considers networks as simply groups of companies joined together in a larger overarching relationship and each company fulfilled a specific role within the group. There are a great variety of different forms for business networks involving technology licensing, franchising, R&D arrangements, information services, supply, marketing and advertising arrangements, etc.

The nature of a hotel chain is different from a single firm. The formation of a chain is a process of networking. The process of chain formation is a kind of network where a hotel management company acts as a core and invests or attracts hotels to the pool to form a network through selling their management or know-how.

2.1.2 Theoretical background

2.1.2.1 Nature of hotel chains

The function and nature of the industrial firm is to make use of productive resources for the purpose of supplying goods and services to the economy in accordance with plans developed and put into effect within the firm (Penrose, 1995). The hotel industry is more of a service nature. The hotel firm has a dual nature as a property business and a retailing operation (Ingram, 1996), which represents real estate investment and specialized service business management expertise, and involves many aspects of business e.g. development, ownership, franchising and management (Go et al., 1990). The formation of a hotel chain is even more complicated, as it concerns not one hotel property, but various hotels and the environment, market situation, industry structure. Most hotel chains started from the growth of hotel management companies and expanded on the base of the ability of the management companies. To some degree, the formation of a hotel chain can be regarded as a hotel management company selling its management services to independent hotels. The quality of their “service” will be very important to acceptance by independent hotels and further expansion.

2.1.2.2 Hotel chains versus independent hotels

The world hotel industry is dominated by hotel chains. Of the world’s total of 15.4 million rooms in the accommodation facilities, over 5 million rooms were controlled by the top 300 hotel chains, and 2.7 million by just the top ten (Pine, 2001). It is widely believed that chain operation is more favorable than independent operation in many aspects. A UN report states that chain hotels are 9% more profitable than independent units (Litteljohn, 1985). Why hotel chains achieve the competitive

advantages over independent hotels can be explained with the theory of economy of scale, transaction cost and the management and technology advantages.

2.1.2.2.1 Economy of scale

Economy of scale (Nooteboom, 1986; Ingram, 1996; Go et al., 1990; Megan, 1999) or scale effect is the most direct beneficial effect of chain operation. Increase in the size of the firm can improve efficiency by reducing the capital costs per unit of a firm's capacity, operating costs per unit of output, non-manufacturing costs per unit of output and improve buyer power through central purchasing to reduce cost significantly (Hart, Spizizen & Wyckoff, 1984).

2.1.2.2.2 Transaction cost

Another obvious effect of the portfolio of hotels is the ability to develop reputations through repeated interactions (Ingram, 1996), which can generate stable reputation and business. The "transaction cost theory" (Williamson, 1975; Casson, 1981; Hill and Kim, 1988; Jarillo & Stevenson, 1991) can be applied to the purchase of product, when the purchaser is uncertain about the specific product to purchase, owing to lack of information, or "information asymmetries". Dunning and McQueen (1982) analyzed the decision-making process of hotel consumption and found that usually the consumer searched the product to examine and compare its quality with the claims of the supplier before a choice was made. The standardized product, service and quality control of hotel chains could offer the necessary information before purchase and reduce customer's uncertainty (Litteljohn, 1985), which reduced the risk taken by consumers and gave them more confidence. The multiple locations of hotel chains could let the customer determine the quality of a hotel before they checked in, and has an incentive to encourage future patronage (Ingram, 1996).

Branding of hotel chains could ensure a guest flow through worldwide brand-name recognition and reservation access (Gee, 1994).

2.1.2.2.3 Management and technology perspectives

Hotel chains developed another effective tool of competition - technology, especially software and hardware designed to maximize profits for hotels (Megan, 1999). Hotel chains have greater investments in technology to operate a centralized, computerized, advance reservation system and enjoy the advantages of reservation systems (Dunning & McQueen, 1982; Go et al., 1990).

As modern hierarchical organizations, hotel chains have more preferential management advantages. More operational skills and management expertise can be generated, for example: operations in advertising and cash management (Caraux 1976); additional accounting and control information; better generation and use of management expertise (Dunning & McQueen, 1982) and advantages in better marketing programs; bulk purchasing programs (Go et al., 1990); technical advice and consultation; and, operating standards and systems (Gee, 1994). Greater investment can be put into human resources development to produce better staff training programs and improve staff efficiencies (Dunning & McQueen, 1982; Go et al., 1990; Megan, 1999). In addition, hotel chains have more power in marketing. The guarantee of services from the trademark (McQueen, 1992), the larger frequent guest programs (Megan, 1999), familiar product or services, and quality assurance can bring more business to a remote market (Yu, 1999). Moreover, hotel companies can harbor market stability through differentiation (Roper, 1995) and lower the market risk through control from headquarters and the various hotel units.

2.1.2.2.4 Disadvantages of hotel chains

Though hotel chains have comparative advantages over independent hotels, there are still weaknesses in such hierarchical, bureaucratic organizations. Big management companies have difficulty in maintaining firsthand relationships with the properties (Watkins, 1992), which may result in late response to the specific markets and information. The drive to consolidate by mergers and acquisitions does not always produce value, because it is arguable at what scale and to what extent the economy of scale can be achieved (Megan, 1999). The development of information technology and the cost-reduction computer reservation systems and the new forms of alliance such as sales representation organizations, joint marketing agreement, technical services agreements, and variants of similar agreements may also dilute the advantages of hotel chains over independent hotels (Litteljohn, 1985).

2.1.2.3 Strategies for hotel chain development

Though hotel chains have comparative advantages over other business forms in the hotel industry, hotel chains need to employ different strategies to improve productivity and competitiveness, and maintain their market position to outperform independent hotels and rivals. Generally firms have four broad categories of objectives: achieving operating efficiency; achieving uniqueness; managing risk; and learning (Ghosha, 1987; Kogut, 1990), which can be achieved in four distinctive ways in relation to hotels.

2.1.2.3.1 Geographic expansion

Geographic expansion of the existing chains to other places is used by hotel chains to develop new markets, increase market share, and maintain profitable growth (Go et al., 1990). Hotel chains with a broad geographic scope and operating a diverse range of brands should benefit from reduced variability of earnings compared with more focused operators (Horsburgh, 1991). Moreover, many hotel chains not only expand in their home country, but also to other nations. Internationalization then becomes an important strategy for many companies in maintaining and extending market share and gaining competitive advantages in a complex and dynamic operating environment (Litteljohn & Beattie, 1992).

2.1.2.3.2 Branding

Brand recognition and brand loyalty are important marketing strategies (Yu, 1999). Branding in targeting markets promotes standards and standardization of products associated with the brand name, and helps streamlining the exchange between buyers and sellers (Gee, 1994). More importantly, branding can assist hotel chains in achieving economies of scale. Through sharing the cost, it is more economical to develop more brands in the hotel portfolio and strengthen their position.

2.1.2.3.3 Segmentation

Hotel chains develop segmented products to face the increasingly competitive market environment (Gee, 1994), as standardization of the product for the market segmentation allows hotel chains to aggregate demand across a large number of locations. However, when segmenting the market, hotel chains need to regard the number of brands they have identified in their portfolios (Slattery, 1991), as segment

scope is an important factor influencing hotel chains location decision and further expansion.

2.1.2.3.4 Product Market Position

Distinct product market position is often defined by performance on low cost, differentiation on focus strategies (Porter, 1985), which means hotel chains need to enhance uniqueness or superior service quality. To develop such a strategy, focus should be placed on the range of markets served, number of brands in the portfolio, pattern of hotel demand and geographic scope (Horsburgh, 1991).

2.2 Formation of hotel chains

Recent researchers in the hotel field are interested in globalization or multinational development of hotel chains and produce many papers on this topic, e.g. Litteljohn (1985, 1997), Beattie (1991), Olsen (1993), Go & Pine (1995), but little has been done on the initiation of hotel chains and how they grow at the early stage. In fact, the latter will be more meaningful to hotel development in the new emerging or developing markets. As international expansion in hotel companies is almost always achieved through chain development, international expansion and chain development can be regarded as synonymous to some degree. This research will include and learn from these authors.

2.2.1 Participants within hotel chains

The world hotel industry involves many players, evolving over many years, forming a very complicated scenario in investment, ownership, management and operation. A

hotel chain is defined as a hotel company that has at least two hotels under operation. It concerns mainly two parties - hotel companies and various independent hotels, and other supporting organizations e.g. financial institutions.

Hotel management companies act as the core of chain formation, operation and expansion, and try to absorb more qualified independent hotels to the pool, which can organize a chain with different models. Gee (1994) generalized these as:

- Companies that own and operate hotels;
- Management companies that operate hotels through the use of management agreements with little or no financial involvement;
- Companies that simply franchise their hotel name without providing any management or operating expertise aside from marketing;
- Hotel management companies that manage franchised or non-franchised hotels for their owners;
- Hotel referral organizations that provide reservation services and limited marketing services for their members.

2.2.2 Process of chain formation

The historical development of hotel chain experienced several stages with first, the mushrooming of many independent hotels. Based on the success of several capable hotels, they created a brand, management system and used them for “internal expansion”. With the increase of more hotels, the market structure of the hotel industry became a “buyer market”, which favored the hotel companies taking over the property or management rights.

An antecedent factor for hotel chain formation is the separation of management functions from the ownership (Tisdell, 1990; Gee, 1994). Early hotel developers usually directly invested and operated hotel properties, as the dual nature of the hotel industry (Ingram, 1996) could bring benefits both from the real estate value and the operational profit. However, as these hotel projects were capital-intensive, this kind of self-own and operation situation resulted in slow expansion of hotel chains. Separation of assets and management in a hotel company enables a hotel chain to grow more rapidly, as it divides the functions of assets developer and property manager, who can play different but more professional roles in a hotel chain. Effectively separated operational and investment responsibilities let hotel chains focus on professional management roles, such as standardization of operations, segmentation of hotel products, marketing, branding, management contracting, franchising systems and centralized computer reservation systems (Litteljohn & Beattie, 1992; Gee, 1994) and improve the capability of hotel chains to handle more hotels.

Past case studies have demonstrated that hotel chain development heavily relied on the role of key figures of the company or the entrepreneurship of an individual, e.g. Ellsworth Statler of Sheraton, Conard Hilton of Hilton Company, and Kemmons Wilson of Holiday Inn. The actions and attitudes of the senior managers have substantial impact on the formulation of strategy, conditioning the activities and other people in the organization (Ruddy, 1991). Most of hotel chains were initiated and brought up by the creative thoughts and measures of industry entrepreneurs. Their initiative and creation of hotel chain operation greatly changed the hotel industry. With the strong personal motivation, the origin of an initiative lies in the

identification of an opportunity to use or expand the corporation's resources (Birkinshaw, 1997). The decision to search for opportunities is an enterprising decision requiring entrepreneurial intuition and imagination and the examination of opportunities for expansion. The quality of entrepreneurial service includes entrepreneurial versatility, fund-raising ingenuity, entrepreneurial ambition, and entrepreneurial judgment (Penrose, 1995).

Ingram (1996) stated a critical difference between a hotel chain and an independent hotel was the reliance on professional managers. At the initial stage, the creativity and activity of senior management is the key to the formation of a hotel chain; an entrepreneurial innovative management style (Harris & Harris, 1985) will then be important to the development of a chain. Human resources and effective training programs could be critical factors in contributing to the future growth of hotels (Moutinho et al, 1995).

2.3 Overview of chain operation in the hotel industry

2.3.1 Emergence of hotel chains

In the early twentieth century chain operation became an important business form in industries such as retail, food service, insurance and banking (Ingram, 1996). Traditionally, the hotel industry was dominated by owner-operated, independent enterprises and could be considered as a cottage industry (Gee, 1994; Ingram, 1996). During the twentieth century, professionally managed, multi-unit organization hotel chains began to rise (Ingram, 1996). Technological advances of the automobile in the 1890s and the jet aircraft in the 1940s significantly accelerated the rapid

expansion of the travel industry (Stewart, 1989). The growth of air travel stimulated the hotel business to provide standardized product and service at key destinations. Many chains developed throughout the fast-paced travel growth years from the 1950s to 1970s by expanding their product to as many locations as possible (Olsen, 1991). Through operating several large hotels under a single management with similar name, style, and size, hotel chains could experience economic and financial advantages (Gee, 1994). The concept and practice of chain operation prevailed in the industry especially since the emergence of Hilton as the first modern hotel management company, and the franchising and national reservations network established by Holiday Inn.

2.3.2 Expansion of hotel chains and their influence on industry structure

Motivated by more profit and market share, hotel chains expanded aggressively to add more and more hotels to their stocks. For instance, between 1983 and 1989 the room supply of the world's top 200 hotel chains grew by 29 percent from 2.2 million to 2.8 million rooms (Horsburgh, 1991). The fast growth of hotel chains resulted in high concentration and consolidation in the world hotel industry. Between 1970 and 1989, the number of rooms affiliated with the top 20 hotel chains increased from 576,000 to 1,844,000 (Gee, 1994). By 2000 there were only nine companies with more than 100,000 rooms, but their total room count was 2.89 million of the 5.72 hotels in the world in the annual survey conducted by the publication "*Hotels*" (Pine, 2001) (table 3).

Hotel chains developed most vigorously in both quantity and quality in the US and could be considered the yardstick for the international hotel industry (Litteljohn &

Beattie, 1992). Among the world's 300 largest hotel chains, 163 of them are headquartered in the US (Hotels, 1999) and the tools of franchising and management contract are used most successfully in their geographic expansion. Then mergers, acquisitions and bankruptcies greatly changed the US hotel chain market (Wolff, 1991). Owing to the success of hotel chains, the independent hotels kept on dropping in market share from 49.8 percent of all hotels in 1993 to 39.6 percent by 1998 in the U.S. (Hotel & Motel Management, 1999).

2.3.3 Internationalization of major hotel chains

Due to the saturation of lodging markets in developed countries, many hotel chains look to globalization or internationalization (Beattie, 1991; Go & Pine, 1995; Zhao & Olsen, 1997; Litteljohn, 1997) to explore the new markets and development opportunities for future survival and growth. Based on the belief that future profitability is driven by scale (Barney, 1998), many hotel chains adopted the market penetration strategies in other countries through the growth of their brands to enter a large number of locations (Litteljohn & Beattie, 1992; Olsen, 1993). Hence, the international market is dominated by hotel chains and led by several North America mega-chains, e.g. Starwood, Marriott International, Hilton, and Bass Hotels & Resorts. In recent years, the international hotel companies are expanding outside the heavily consolidated North American market into the more fragmented new emerging destinations (Barney, 1998) (table 4).

The structure of the world hotel industry favored the giant multinational hotel chains, mostly originated in few developed countries, especially in the US, which may leave less room for hotel development in the new emerging market or soon be occupied by

the big players. The leading international hotel chains increased their share of host country markets to outperform chains of other nationalities (Dunning, 1988), which put pressure on hotel companies in developing countries.

2.4 Overview of the hotel industry and hotel chains in China

Since 1978, with the increase of the opening-up and reform policy in China, the hotel industry has been one of the fastest growing industries in China and quickly reached international standards in some sectors. The hotel industry has experienced some fundamental changes from hotel shortage to overprovision, transition of purpose from political reception to business operation, political symbol towards internationalization in operation and management.

Table 5 illustrates how the industry has progressed from 1980 to its relatively large size in 1999. By 1999 the total number of hotel in China reached 7,035, with 889,430 rooms, fixed assets of RMB 236.94 billion, revenue RMB 84.57 billion, and tax RMB 4.27 billion (CNTA, 2000).

2.4.1 The historical development of China's hotel industry

2.4.1.1 Hotel industry before 1978

China did not have hotels of an international standard before 1978. Commercial accommodation facilities were few in number and of very poor quality at that time (EIU, 1989; Zhao, 1989). Most of the lodging facilities for domestic travelers were low standard “Zhao Dai Suo” (small inn). The few accommodation facilities that catered to international visitors, called ‘guest houses’, were restricted to high-

ranking government officials or foreign political visitors. Such lodgings could not be considered as an industry, but part of government's "political reception" function.

Most guesthouses were imitations of Russian style architecture, equipment, facilities and management. Though these guesthouses had higher standards than "Zhao Dai Suo", they were still poorer than modern hotels in the western world in terms of functions, services and equipment (Zhao, 1989). Even then, the guesthouses were not available in most cities of China. When China opened to the world in 1978, the low capacity and poor accommodation could not support the massive inbound tourism.

2.4.1.2 From 1978 to 1989

This was a most dramatic period of change for China's hotel industry. When China first opened up to international tourists in the late 1970s, the sudden influx of overseas tourists created a great demand on China's undeveloped hotels and the shortage of hotel capacity was a severe bottleneck within the tourism industry (EIU, 1989; Yu, 1992). The serious problem of the under-capacity of the hotel industry urged the Chinese government to expand hotels (Zhao, 1989; Zhang, 1989). How to ease the shortage of supply became the top priority in the tourist authority's agenda, and two measures were deployed: changing most of the guesthouses from political reception use to tourist industry use, and attracting investment for new hotel projects.

From 1979 to 1982, the Chinese government transferred 14,000 guesthouse beds to the tourist industry (CNTA, 1983). At the same time, great efforts from both the government and the industry had been put into hotel construction and renovation to match the anticipated increase number of tourists (Zhang, 1989; EIU, 1989). An

investment policy encouraging foreign investors in the construction of joint-venture hotels and using the collective capital for tourist hotels were set up (Zhao, 1989). From 1978 to 1982, a total of 18,346 new beds were added in China (CNTA, 1983). With the provision of more beds, the shortage of accommodation facilities began to ease. (Note: China uses “bed” to measure the capacity of accommodation facilities). In terms of market structure, it was impossible to form hotel chains in China when hotel supply was far behind the tourist demand, and individual hotels were not motivated for expansion as the business was already very good.

2.4.1.2.1 Foreign investment and management

In order to solve the problem of hotel shortage, one important policy was to attract foreign investment to build hotels, as China lacked capital, technology and management expertise (Zhao, 1989). A number of laws and regulations were created, which included the Law on Chinese-Foreign Equity Joint Ventures (1979), the Income Tax Law Concerning Foreign Enterprises (1981) and the Law on Chinese-foreign Cooperative Enterprises (1988). In Addition, the Chinese government set up a more preferential policy toward joint-venture hotels, new hotels could be exempted from tax for three years and then 50% exemption for two years (Zhao, 1989). Foreign invested hotels could obtain special privileges over Chinese enterprises in areas such as recruitment, import and export procedures and distribution of income. They could enter China in flexible ways, which varied from international commercial loans, joint venture, cooperative operations, sole overseas-invested business, partial cooperation, compensation trade, to overseas management agreement (EIU, 1989). The rapid growth of China’s hotel industry in this period was pushed by both market demand and incentives from the Chinese government.

(Yu, 1992). International investors were attracted by high profitability and the market opportunities of a major developing destination (EIU, 1989).

The opening of the Beijing Jianguo Hotel, the first Sino-foreign joint venture in 1982 was regarded as a cornerstone of China's hotel industry development. The Sino-US co-invested property was under a management contract with the Hong Kong based Peninsula Hotel Management Group (Yuan, 1998). The foreign partner brought substantial architectural, design, and management skills to the project to ensure a high operating standard (EIU, 1989). In addition, relevant policy and regulations concerning the hotel industry were also adapted to the new practices. The outstanding performance and the gain for investors on both sides attracted more and more international investors to the hotel industry, leading to a boom in the building of joint-venture hotels with foreign investors in the main tourist cities (Zhao, 1989).

The Jianguo hotel has been regarded as a model of joint venture cooperation since 1984. A movement called "learning from Jianguo" was sponsored in China by SATT (State Administration of Travel & Tourism, now CNTA). 102 hotels were selected to experiment the introduction of Jianguo style management, and the international standard of hardware and software set by that joint venture (He, 1992; EIU, 1992). The introduction of foreign investment and management know-how had a great impact on China's hotel development (Yu, 1992), as the Chinese government took foreign participation as an important way to reform the inefficient state-owned hotel sector. Through the campaign of "learning from Jianguo" and later more foreign involvement, the Chinese hotel industry was brought to a new standard.

Besides direct equity participation, contractual agreements by the transnational hotel corporations were another important form of foreign participation in the Chinese hotel industry (Oudiette, 1990), which brought about the contemporary management expertise which Chinese hotels lacked. Before the arrival of foreign hotel management companies, China's hotel industry had little exposure to international management and service standards. Poor hotel management and inadequate hotel service were the major complaints from overseas tourists. Foreign management companies provided contemporary systematic management practice and adequate training for local employees, and also tied the hotels in China into their international reservation system thus increasing hotel sales to overseas travel agents.

More importantly, the technology transfer (Pine, 1991) then incurred enabled more Chinese hotels to improve their management and service, and upgraded the Chinese hotel industry at large. Pine (1992) analyzed technology transfer from the perspectives of general, service sector, tourism and hotel industry and pointed out that technology transfer could only proceed successfully if the technology receivers were capable and willing participants in the transfer process. The provision of a thorough general education plus specific vocational skill development, through vocational education, industry training and work experience, were vital for the continued and successful development of the hotel industry internationally, and particularly in developing countries. Pine (1991) defined technology transfer in the hotel industry as the ability of local nationals to adopt and adapt existing hotel systems, possibly to the point of creating new systems, to continuously satisfy both international and domestic demand for hotel services. This reveals that China's hotel chains should not only have the capability to operate a hotel directly copying from

the western hotels, but also have investment capacity and innovation capability to modify and improve methods and products that are specifically suited to a China context.

2.4.1.2.2 Star-rating system and its contribution to chain operation

Though the hotel industry in China changed a lot in terms of quantity, the service quality of most hotels still remained at a low level. Service problems were often attributed to the wide variation of hotel facilities and services, the lack of uniform hotel operation standards, inexperienced work-force (Tisdell & Wen, 1989), inadequate and unreliable information for marketing and planning (Liu & Liu, 1993), and lack of coordination in hotel administration owing to the complicated bureaucratic and financial structure (Zhao, 1989).

In 1988, a star-rating system, adapted from international standards, was established by CNTA, aiming to differentiate hotels and improve facilities and services. Through the successful implementation of this system, a national hotel operation standard was established and the hotel administration process was streamlined (Wei, 1994; Liu & Liu, 1993). The Chinese hotel industry has gradually moved towards a greater degree of standardization and professionalism (Liu & Liu, 1993), which offered a base for uniformity and networking of hotels. In 1993 the star-rating system was adopted as a national standard across the country. At that time star-rated hotels totaled 1,186, accounting for 46.47% of total hotels and 60.04% of hotel rooms. The system was further revised in 1998 according to the industry practices, which included the procedures of rating facilities, equipment, maintenance, cleaning, hygiene, service, quality, and guest satisfaction.

The star-rating system enabled better consolidation in the hotel industry as it encouraged consistent product identity and performance of hotels (Liu & Liu, 1993). In fact, through this system, some outstanding hotels could enhance their position in the market by brand recognition and spread their management expertise to other hotels to start the formation of a chain.

2.4.1.3 From 1989 to 1998

Political turmoil in Beijing in 1989 caused a slump of China's tourism industry. China's international tourist receipts decreased from US\$ 2.24 billion in 1988 to US\$ 1.86 billion in 1989 (CNTA, 1990). The hotel room supply annual increase rate of 21.5% in 1989 dropped to 9.83% in 1990, and continued to drop for three consecutive years (Wei & Shen, 1999).

In 1992 when China widened its economic reform and opening policy, the increased business activities and tourist arrivals stimulated hotel investment. The Chinese hotel industry experienced another period of boom. From 1993 to 1997 China doubled its hotel capacity from 2552 to 5201 hotels, with room supply increasing from 386,000 to 701,700 (CNTA, 1993-1997). This was an important period for many MNHCs' strategic development in China, which aimed to get more market share and future profitability from China's potential travel industry. In 1994 there emerged the first joint venture hotel management company - the Sheraton Orient Hotel Management Company Limited (Sheraton News Release, 1996). However, the expansion of Chinese hotel companies still stagnated with only a few exceptions owing to the complexity of the business environment and the incompetence of these companies.

The rapid growth of hotels in this period began to bring about another round of oversupply in China's hotel industry. More and more real estate properties shifted their business to hotels, which increased extra accommodation facilities and created difficulties for the hotel industry. In addition, the Asian Financial Crisis that erupted in 1997 shadowed the tourism and hotel business in Asia and inevitably affected the hotel industry in China. In 1998, for the first time, the Chinese hotel industry as a whole had a loss of RMB 4.656 billion (CNTA, 1999). This had some influence on the hotel industry to concentrate and consolidate in face of the fiercer competition.

2.4.2 The current situation of hotel chain operation in China

2.4.2.1 Changes of the hotel industry and implications on chain operation

2.4.2.1.1 Overprovision and control of new construction

From 1993 to 1997, accommodation capacity in China doubled from 2,552 hotels with 386,000 rooms to 5,201 with 701,700 rooms. This rapid growth is attributed first to the immense flood of investment to new hotel buildings, as in a certain period the profit rate and the return of investment in the hotel industry are much better than other industries; second, the transfer of real estate projects to hotel business through function adjustment and renovation, as the real estate market was hugely oversupplied in recent years. Though the government strictly restricted the construction of new hotel projects, hotel room supply still increased very quickly. In 1998 for the first time the whole hotel industry recorded a loss. According to projected tourist increase, hotel overprovision will last for at least another ten years in terms of its supply and demand ratio.

2.4.2.1.2 Imbalance of hotels among different regions

The imbalance of hotels between different regions influences the chain formation as the management level and service quality vary from region to region, which may require more input for some hotel companies in the less developed places. Generally, hotels in the coastal cities such as Shanghai, Guangzhou, and Shenzhen reach a higher standard in terms of both quantity and quality. The hotel industry in those provinces in central China is experiencing a fast development, but hotels in the west provinces are still in the phase of start up (table 6).

2.4.2.1.3 Star-rating hotels

Generally star hotels account for only 54.8% of the total hotel industry in 1999. In those star hotels, one-star hotels are of a relatively small ratio (table 7). The main reason why one-star hotels are so few needs further examination. It is also argued that there are too many high star hotels in China, while the regional distribution and performance of these hotels differ. Generally the supply of hotels should be strictly controlled in the future, but the structure of the industry should be rationalized. Some regions do not even have a high star hotel. For example, until 1999 there were thirteen provinces with no five-star hotels and five provinces with no four-star hotels. Most high star hotels are concentrated in Beijing, Shanghai and Guangdong. The imbalance also exists in terms of other star levels, and may have some implication for the hotel industry.

2.4.2.1.4 Hotel size and chain

There are some large single hotels in China, for example, 98 hotels with rooms over 500, which account for 14.35% of the total hotel rooms in 1999. However, most

hotels are just a single large building and only a few numbers of hotels have developed a network to form a chain.

Chain formation and operation has just started in China and has not reached a large scale, which may be attributed to the unusual concept, economic development level, technology, market access barrier and commercialization. Weak competitiveness of the Chinese hotel industry is due to the lack of large hotel groups or chains as only a very small number of hotels are operated by hotel management companies, most hotels are independent and cannot compete in the world market.

2.4.2.2 Chain operations introduced by foreign management

Since 1982 a new trend of using foreign hotel management companies emerged in the Chinese hotel industry. By 1987, there were more than 30 hotels managed by foreign MNHCs in China (Zhao, 1989). Many modern Chinese hotels, either Chinese owned, or joint venture, invited international hotel chains or management companies to run their hotels (EIU, 1989). The advanced management techniques and technology imported by MNHCs greatly changed the operation of individual Chinese hotels. More importantly, most of these hotel firms were chain operated, which introduced the concept and practice of chain operation to China. These hotel companies had more and more business presence in China and expanded gradually to put hotels in key tourist destinations, enjoying the advantages of centralized management, and also more market share. For instance, the Jianguo hotel soon expanded to Xi'an after its success in Beijing. ITT Sheraton, with its first opening in China in 1985, The Great Wall Sheraton Beijing, added 4 hotels in the ensuing six years. Holiday Inn became the biggest hotel chain in China, with 18 hotels under

management since it first entered China in 1985. The expansion of these MNHCs had implications for the Chinese hotel industry far beyond the management and operation of an individual hotel after the concept of chain operation and conglomeration was introduced. More importantly the entry of MNHCs forced the state-owned hotels to speed up reform in various aspects, and to partially break up the local protectionism through their expansion across the nation.

2.4.2.3 Dominance of multinational hotel companies

Since China's opening-up and reform, some MNHCs targeted this huge potential market and penetrated gradually. In 1984 Holiday Inn managed the Beijing Lido Hotel. From then on, many MNHCs entered and expanded their networks in China. Now Bass Hotels & Resorts is the largest hotel chain in China, operating 23 hotels in 1998. Shangri-la has 36 hotels in the world, 13 of them are in China. This company puts emphasis on the Mainland China market and has become one of the most aggressive hotel management companies in China. The New World Hotels manages eight hotels in China and projects to manage 50 hotels in the next decade. The company was acquired by Marriott and became a base for Marriott's penetration into China. Hyatt operates 3 hotels in China; other companies include Accor, 4 hotels; Sheraton 5; All Nippon Airways 4; Hilton 3; Peninsular 6; Kempinski 3 (Wei & Shen, 1999). Until now, most of the high star hotels in China are managed by MNHCs, which are in a leading position in market share and performance in hotels in China, owing to their advantages in information and reservation, marketing, management, and training.

Most MNHCs expand in China by management, but not direct investment. However, some hotel owners in China have requirements on capital involvement when negotiating the management contract. Some hotel companies have started to invest partially in China, adapting to the particular circumstance in the country. Some hotel companies use direct investment to build and operate hotels in China. For example, Shangri-la has full capital involvement or partial capital involvement.

Some hotel companies have other means to raise funds for hotel development in China, for example, Sheraton plans to raise US\$ 0.3 billion in cooperation with Morgan Investment Bank to develop hotels and Accor plans to raise US\$ 0.3 billion in the European capital market to set up a China Hotel Development Fund (Wei & Shen, 1999). Presently the upscale hotel management is dominated by MNHCs. MNHCs are quite large in scale and market share in China and have more comparative advantages in operation. This trend will not cease, but will develop further in the future, especially after China's accession to the World Trade Organization (Pine, 2001).

2.4.2.4 Indigenous hotel chains

Though foreign MNHCs contributed to the development of China's hotel industry, with more and more hotels opening in China, heavy reliance on foreign management brought about new problems. The first was the leakage of tourism revenue, which included not only the management fees, and sharing of profit, but also the expenses of expatriate managers. The preferential treatment for foreign participated hotels put Chinese hotels in an unfavorable competitive position. Owing to the monopoly or dominance of the reservation systems, some management companies did not carry

sufficient responsibility of management but rather received a fixed management fee plus additional preferential benefits (EIU, 1989).

In 1988, to reduce the risk of heavy reliance on foreign hotel management companies and to gain some share of the hotel management market, the first Chinese hotel management company - White Swan Hotel Management Company - was established in Guangzhou (Yuan, 1998). Several consortia, for example, Lianyi Hotel Group, sponsored by Beijing Xiyuan Hotel and another ten hotels, and the Hualong Tourist Hotel Group and Friendship Tourist Hotel Group, also appeared (Yuan, 1998). More of these kinds of hotel consortia or referral systems were formed in later years, e.g. VIP Hotel Club, the Friendship Hotels, and CITIC Hotels Affiliation. However, none of them expanded to a large scale, though this kind of organization did have some cooperation, joint marketing, reservation and purchasing activities.

One driving force to form hotel chains was the big change of the Chinese hotel industry from under-provision to overprovision of hotel rooms. Though the Chinese hotel industry developed rapidly from 1978 to 1988, the fast growth also brought about many problems, which were mainly caused by overprovision (Zhao, 1989; EIU, 1989), geographic imbalance (Liu & Liu, 1993), and unreasonable distribution of star-hotels (Zhang, 1989). Problems of overcapacity and a slump in operating profit resulted in amendment of the government's hotel development policy to tighten control over the construction of hotels (CNTA, 1995). More attention was then paid to the development of national hotel groups to rationalize the hotel sector.

To support the development of hotel management companies, some preferential and supporting policies were made. For example, in 1988 the State Council and the General Custom approved that hotels managed by domestic hotel management companies can enjoy all the same treatment as joint venture hotels. But this policy was not fully used by the industry and was aborted later.

Owing to the unique economic and ownership system, the formation of indigenous hotel chains is quite different from that of MNHCs. As most hotels are invested by government departments or conglomerates, hotels under these agencies are most likely to form chains. For example, some monopoly sectors e.g. electricity, post & telecom, tobacco, and transportation, have integrated many properties into a chain. Another effective way is to form a chain by the political administrative system, especially for those hotels owned by the departments of the central government. For example, the Bank of China is the sole owner of five hotels, and has shares in 200 hotels nationwide, with total assets of US\$ 4 billion. In 1997 the Bank of China set up a hotel management company to operate those hotels and take advantage of chain and assets operation. Another interesting scene is that some Chinese companies abroad return to China and invest in the hotel industry. Two cases are Gloria hotels, which is a Hong Kong-based hotel management company, acquired by China Oil, Food, Cereal Import & Export Corporation (COFCO), but invested RMB 4 billion in 12 hotels in China. The company is rated no. 219 in world's top 300 hotel chains (Hotels, 2000). Another one is the hotel management company under the China Travel Service based in Hong Kong, which manages 20 hotels in China.

The diversification of those conglomerates to the hotel industry to form chains has some comparative advantages, which include the capability of raising funds, strategy, networking, and internal management. Driven by the reforms on enterprises at the national level, some companies developed to a large scale through merger/acquisition, and also diversified to the hotel and tourism industry. For example, the Yunnan Hongta Group, the largest tobacco company in China, shifted quite a lot of its assets from the “sunset” tobacco industry to the “sun-rising” tourism industry and formed a tourism company with nearly RMB 1 billion assets, which include one four-star and three three-star hotels, then expand outside of Yunnan (Wei & Shen, 1999).

Traditionally hotel and tourism conglomerates belong to or are established by tourism authorities at different levels. In recent years, several provinces, e.g. Guangdong, Anhui, and Jiangsu, combined all their tourism firms under one local conglomerate company. The Beijing Municipal government put 108 enterprises into one Beijing Tourism Group, with total assets of RMB 10.7 billion. However most of these firms, including many hotels, are confined to Beijing only.

2.5 Constraints in hotel chain development in China

Firms have a variety of inducements to expand, but also difficulties to overcome in expansion, which may be external or within the firm. They create conditions enhancing or restricting the profitability or practicability of expansion in particular directions. The limitations to the growth of firms include managerial ability, product of the market, uncertainty and risk (Penrose, 1995).

The barriers to hotel chain growth in China have some particular aspects in both external and internal obstacles, which influence not only the development of indigenous hotel companies, but also MNHCs. For example, Holiday Inn Hotels had a very ambitious plan to expand in China, but by 2000 the company had reached only 20 hotels, far less than expected.

2.5.1 Economic system and mechanism

2.5.1.1 Paradox of a transitional economy

Since 1978 China adopted an opening and reform policy to gradually transform its economy towards a market-oriented system, which created a better business environment for hotel development. However, China has not yet finished its economic transition and remains as a mixed economy system, where market principles and the central planning system interact and conflict. As China is now in a particular period of transition from planned economy to market economy, the state-owned hotels are still obedient to the traditional administrative system. State hotels that belong to different government bodies and administrative departments are not actual firms in the market and cannot act like a commercial business. Though some hotels are conglomerated by the government, they cannot break the barriers of ownership system and protectionism to achieve competitiveness in the market.

2.5.1.2 Government intervention

Government officials heavily influence the hotel industry, and may interfere with actual hotel management and operation (Tisdell & Wen, 1991). Too much bureaucratic control over hotels may cause a waste of resources, low efficiency and a lack of innovative entrepreneurs (Yu, 1999) whilst preventing the growth of hotels

and hotel companies. For example, a typical phenomenon in China is “local protectionism”, which means the barriers set by the government of one region prevents the accession of investment and commodities from other regions to its territory. These policies greatly affect hotel expansion from one region to others within China.

2.5.1.3 Policy restriction and interest groups

There are also policy restrictions and interest groups influencing hotel chain formation. As state-owned hotels are invested by different government agencies with various interests, most hotels are difficult to incorporate into chains. The current regulations limit the free flow of state-owned assets in the market. It is also difficult for the existing hotel chains to handle these state-owned hotels. Take a new hotel group for example, the China Post & Telecom Tourism Group, a newly organized holding company under the Ministry of Information Industry, is willing to handle all the hotels owned by the Ministry of Information Industry to make its own presence in the hotel market. However, most of these hotels under the Ministry of Information Industry are invested in the name of local bureaus, and during the course of re-organization, there are constant conflicts to shift these assets to the holding company.

In China, hotel assets are controlled by different government bodies, which are seldom willing to give up the right of control that brings them benefits, even though some hotels are losing money. The reform of some basic disciplines of regulations is still needed to create a better business climate for hotel chain development in China.

2.5.1.4 Lack of motivation and drive

Traditional firms that are backward in internal management and decision-making mechanism are also conservative in ideology and new ideas, and lack vitality and sensitivity to changes in the environment and market. Hotels belonging to government departments rely heavily on the political administrative system to form a chain or network, but not the market mechanism. The market mechanism is distorted in China in the transition period because firms cannot compete freely in a normal business environment according to their own conditions and plans, but are often interfered with by the government.

Market economy has been fostered in China for only a short time and is far from mature. The administrative system of the planned economy is broken step by step while the market mechanism has not been established yet. Some “firms” cannot be considered as firms and cannot act like firms in the existing non-market environment. In addition, the existing obstacles raise the transaction cost of firms, e.g. local protectionism and monopoly in some industries in China.

2.5.2 Ownership

2.5.2.1 Complexity and diversity of the ownership system

The issue of ownership and control over assets and operations is one of the central problems in the negotiation and subsequent use of hotel-management or partnership agreements (Saunders & Renaghan, 1992), especially in China, where hotel ownership is quite complex. In the “Seventh Five-Year Plan” (State Planning Commission, 1986-1990), a policy called ‘bringing into play the five sectors’ was implemented to attract more capital, which meant that state, local, departments,

collectives, and private capital owners were all encouraged to invest in the hotel and travel industry (He, 1992). The diversification of investment resulted in the intended acceleration of hotel development (Liu & Liu, 1993). However, the complicated ownership since decentralization in hotel investment led to a severe lack of coordination in decision-making in hotel construction (Tisdell & Wen, 1991). It was estimated that more than 1300 hotels belonged to more than 350 different organizations in 1987 (Zhang, 1988), which made the hotel developers have no sense of chain operation at all.

2.5.2.2 Dominance of the state-owned hotels

Decentralization has resulted in a variety of different types of hotel ownership (Tisdell & Wen, 1991), i.e. collective, private, alliance, stock, foreign-invested, Hong Kong, Macau, and Taiwan invested. However, state ownership is still the dominant mode, accounting for 63% of total hotels and 60% of total rooms (CNTA, 1999). State ownership can cause many problems in terms of chain affiliation, the leading one has been the failure to separate hotel management and ownership (Tisdell, 1990) and lack of effective monitoring of the state assets.

Du & Dai (1998) analyzed the behavior of the state-owned hotels that restrict the chain operation and found that: the non-commercial objectives of the state-owned hotels restrict their renovation; the owner or its representative worries about losing benefits during the course of chain operation; the pressure of the vested interest group, including employees, retired employees etc.; and, ineffective monitoring of hotel management companies after contracting hotels to the management party. It seems that hotel chain formation in China should start from the change of the

ownership system. Wang (1998) suggested an ownership trading market should be established, which would lead to the assets restructuring of Chinese hotels (Xu et al., 1998; Wan & Hu, 1998).

2.5.2.3 Comparison among different ownership types

In the hotels of different ownership type, it is found that foreign invested hotels have much better performance than other hotels (table 8) because most foreign invested hotels are operated by MNHCs according to the rules of market economy and international business practice. In China the vagueness of the ownership system and the restrictions on the free flow of assets limit the concentration of the hotel industry, which greatly disables the growth of hotel management company. Most state-owned hotels lack strategy in their management; they pay more attention to the daily operation and management procedures, but neglect branding, corporate culture and innovation and most importantly the effective use of capital in the market (Ma, 1998).

2.5.3 Hotel management capability and resources

2.5.3.1 Managerial capacity

As the hotel industry in China is a comparatively fledgling one, most local hotel chains are new players in the market and still weak in providing satisfactory service to their client hotels. Many standard international business practices are unknown or unfamiliar within China (EIU, 1989). For example, strategies and expertise, such as standardization, branding, ecology programs, frequent guest programs, and strategic alliances are still new in China. Information technology is another weak point, as no indigenous chain can offer an on-line real-time reservation system for customers.

Zou (1998) specified four severe problems of Chinese hotel chains: lack of marketing network and reservation system; lack of hotel managerial expertise; problems of the capital market and loan; and, protectionism of local authorities.

2.5.3.2 Communication between hotel companies and independent hotels

The weakness of the environment for the Chinese hotel chain development made it difficult to get contracts from individual hotels and expand. Most Chinese hotel owners would prefer self-management to management contract by an incapable party. In a developing market like China, how hotel management companies and hotels communicate, cooperate, and establish rational corporate structure between hotel chains and the portfolio of hotels is vital and skillful (Kong, 1997; Slattery & Clark, 1988).

2.5.3.3 Resources for Chinese hotel companies

How to improve the management skill and the service of hotel management companies is the key factor for the growth and expansion of hotel chains in the future. Improvement of management, further market segmentation and the establishment of a central reservation system are major concerns of China's lodging industry (Yu, 1992). According to Horsburgh (1991), a hotel management company should use its resources to develop its assets, core competence, knowledge, and the ability to learn to create and sustain a critical competitive advantage for hotel development, such as superior knowledge of brand management, real estate development, operation of management contracts, and franchising. The lack of necessary resources, e.g. human resources, capital, and management expertise, made it difficult for Chinese hotel chains to create their organizational capability.

2.5.4 Competition between foreign chains and local chains

As globalization is an obvious trend, most giant hotel chains have expanded to China attracted by its rapid economic growth and tourism development potential (Wise, 1993). Among the world's top 300 corporate chains ranked by Hotels (1999), about 10% of them have entered China and run their business e.g. Hilton, Hyatt, Holiday Inn, Shangri-la, Marriott, Accor, Club Med, Days Inn, Starwood and Cendant. Many hotel chains have set China as a strategic target for their future growth and increased their stocks in this market.

Joint venture hotels account for only 10.22% of the hotels and 15.75% of hotel rooms, but generate 31.78% of the total hotel revenue in China (CNTA, 2000). Most of the joint venture hotels are managed by MNHCs, while state-owned hotels have a much worse performance in terms of room occupancy, profit rate and return of investment (table 8).

In China, the advantages of chain operation by MNHCs are more obvious, as once a hotel has stopped its contract with a hotel chain, business would be affected greatly. For example, the distribution channel of Starwood generates 60% of its revenue (Wang, 1998), while local hotel management companies in China are small in scale and unable to fulfill the full potential advantages of chain operation. Most of the four- or five-star hotels are operated by international hotel chains, while local chains mostly operate three-star and below hotels (Shi, 1997). The most competitive advantages of MNHCs over local chains are economies of scale, management expertise and technology, especially networking by the distribution channel and

centralized reservation systems, which can directly lead the overseas tourists to chain hotels. In addition, foreign hotel chains entered the Chinese market earlier and dominated the market, enjoying favorable policies set by the Chinese government (EIU, 1989). How Chinese domestic chains can fare in a fierce competitive environment and develop their advantages may need some special approaches, such as the participation of the financial sector.

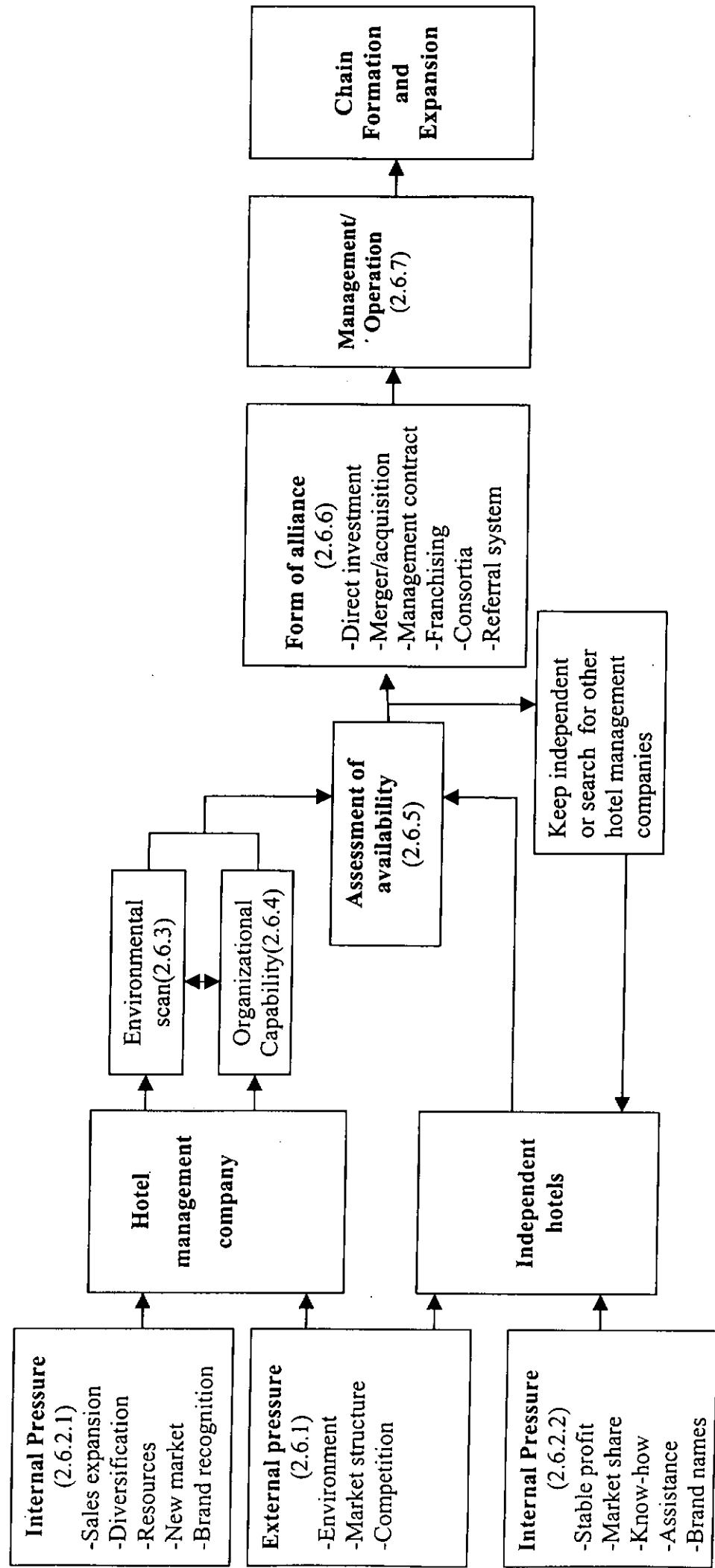
Competition between MNHCs and indigenous hotels is not fair as foreign invested hotels have more preferential policies and treatment than indigenous hotels in taxation, tariff, foreign exchange, pricing, human resources, etc, which put the indigenous hotels at a disadvantage situation and they may completely fail in the market i.e. close down. This is an important reason why many investors seek foreign partners for joint venture and hire a foreign hotel management company (Zhang & Lin, 1998).

2.6 Developing a model to illustrate hotel chain formation

Penrose's model of growth (1995) mainly explores the relation among resources, productive opportunities, managerial competencies, firm size and ways of growth and expansion. Marris's model (1998) discusses the three key elements (assumed motivation, a market valuation model and a theory of takeovers) and incorporates two main relationships (the supply of capital function and the costs of growth function). Based on Penrose and Marris's models of growth and expansion, through reviewing the development of hotel chains in the world and China, a model of hotel chain formation is proposed, which illustrates the process of hotel chain

development (figure 1). The directions of the arrows indicate the relationship and sequence among each factor.

Figure 1. A model of hotel chain formation and expansion
(Relevant text section numbers are indicated in the figure)



Firms which are planning growth and expansion have to take consideration of several key factors, and make serious decisions on strategy, direction, methods, time frame etc., and also need to consider types of investment possibility - whether to set up new capacity within the firm, or expand externally through takeover. Firms need to survive or grow by both the external and internal inducements (Penrose, 1995). Both hotel companies and independent hotels face these inducements or pressure.

2.6.1 External pressure

The external inducements to firms' expansion include growing demand for particular products, changes in technology, discoveries and inventions, special opportunities to obtain a better market position or achieve some monopolistic advantage, and similar conditions and opportunities. They also include changes which might adversely affect a firm's existing operations and against which it could protect itself through expansion in particular directions, for example through backward integration to control sources of supply, diversification of final products to spread risk, or expansion of existing or allied products to preclude the entry of new competitors (Penrose, 1995). In the hotel industry, the external pressure generally comes from three aspects: environmental change, market structure and competition.

The environment in China will change dramatically when China fully transforms its economy from the previous planning system to market economy, which concerns many things like legislation, regulations, pricing, etc. In terms of market change, there are three aspects. First, generally hotel supply surpasses hotel demand and tourist increase, which leads to the difficulty of operation of many independent hotels. Second, the hotel industry is lead to a certain degree of concentration,

especially the favorable position of foreign invested hotels managed by MNHCs. Third, the rapid development of the hotel industry reveals more productive opportunities for hotel management companies to form chains. Market structure determines the behavior of firms in an industry, and that behavior in turn determines the quality of the industry's performance (Caves, 1967). In the early years of the hotel industry, it was impossible to have chain operations due to the immaturity of the market and the under-capacity of hotel provision. The main elements of the market structure of an industry include the degree of seller concentration, conditions of entry, buyer concentration and product differentiation (Akehurst, 1984). The changes in the hotel industry in these aspects, e.g. non-asset possession (Olsen, 1991), the vast geographic distribution, and overprovision of hotel rooms, force the industry to go to chain operation and consolidation to improve competitiveness. To face the structural change of the industry, firms may adopt new tactics and strategies for growth e.g. mergers and takeovers, diversification (Akehurst, 1984), which could lead to the formation of a rudimentary hotel chain. In addition, Competition between independent hotels is fierce as is competition between foreign hotel companies and local hotel companies.

2.6.2 Internal Pressure

To understand the actions behind firms, it is necessary to find why they act. The growth of firms can best be explained by the fact that their investment decisions are guided by opportunities to make money. Internal inducements to expansion arise because there exists a pool of unused productive services, resources, and special knowledge within the firm and those resources can be acquired continuously from the market. Firms will want to expand as fast as they can to take advantage of

opportunities for expansion that they consider profitable. The financial and investment decisions of firms are guided by a desire to increase total long-run profits. The growth of a firm depends on the extent to which it is alert to act upon opportunities for profitable investment.

Marris (1998) assumes that both shareholders and managers are 'maximizing' decision-makers but they have different goals - the shareholders wish to maximize the returns on investment, whereas the managers are interested in maximizing the growth rate of the firm's assets. The difference between owners and managers may also affect the process of chain operation. Managers are concerned with the size and growth of the firm because their salaries, power, prestige and personal advancement depend more on the firm's size than on its profitability. However, there is a limit to the extent to which managers can decide to expand.

Maximizing profit is the inherent nature of all enterprises; hotel firms are no exception. Achieving more profit is surely the basic motivation of hotel companies, while in a modern and complex economic system, this cannot be simply explained, as hotel companies and independent hotels are in different situations and their strategies to compete vary under different circumstances.

2.6.2.1 Internal pressure for hotel companies

Generally the internal pressures pushing a hotel company's growth and expansion are enhancing profit lines through sales expansion; new markets for corporate growth; geographic diversification; acquiring inexpensive resources and labor; worldwide brand recognition and benefits of global brand marketing (Gee, 1994;

Daniels & Radebaugh, 1994); and reducing investment risk by spread of business in different places (Gee, 1994; Yu, 1999).

2.6.2.2 Internal pressure for independent hotels

For an independent hotel, in a highly competitive market, their survival through joining a hotel chain is motivated by stable profit, a certain market share, know-how, brand names, and various technical and other assistance.

It is also necessary to understand the different motives at different stages of hotel chain development. According to Horsburgh (1991), the initial expansion is motivated by the desire to provide a unique home-from-home service for travelers; once the network is established and standardization is sought, hotels aim to achieve higher efficiency goals. Then as the geographic scope increases and the risks can be better controlled, chains desire to seek greater learning opportunities from an enlarged network.

2.6.3 Environmental scan

The scope and complexity of the environment require the management to develop methods to monitor the environment before their decision. The environment factors can be analyzed as the macro external environment and micro task environment (Zhao & Olsen, 1997). External environment covers five aspects: economic, political, technological, socio-cultural, and ecological. The task environment (Dill, 1958) focuses upon forces affecting the industry and its structure, which is given by Porter (1980) as forces from competitors, customers, suppliers, and substitutes. Hotel companies should scan the environment frequently to identify these major factors for

better performance. West & Olsen (1989) suggested that top management should support and grant commitment and time for the hospitality firm to be effectively assimilated to the corporate culture for an environmental scanning system to survive, grow and be effective.

2.6.4 Organizational capability

Faced with the same business environment and market structure, why some hotels can form chains while others fail depends on the organizational capability of the firm. In the early growth model of Penrose, much emphasis has been put on the managerial competence of a firm. Organizational capability, or core competence, a recent theory in management to exploit the sustainable advantages of a firm, is defined as an organization-based capability, that combines and integrates the skills of a set of practitioners working across different business units, and creates superior value for a client (Prahalad & Hamel, 1990).

Overmeer (1997) identified a set of core capabilities in the hotel industry, which included the marketing-directed factors of sales, pricing and marketing planning; the operation-directed factors of intangible and tangible assets, human resource management, and facility management. However, this is not so specific for hotel chains. Horsburgh (1991) put forward some aspects of hotel chain competence such as real estate development, expertise in brand development and trademark, operation of management contracts and franchising, and expertise in choosing superior site locations. Competence building is defined as: “any process by which a firm qualitatively changes its existing stock of assets and capabilities, or creates new abilities to co-ordinate and deploy new or existing assets and capabilities in ways

that help the firm achieve its goals; competence building also involves the creation of new strategic options” (Sanchez et al., 1996, pp.13).

The formation of core competence of hotel management companies largely determines their ability of operation and expansion. Horsburgh (1991) suggested that hotel chains should identify the sources of advantages and invest in the assets, particularly the invisible assets to develop the core competence to achieve the competitive advantage. The formation of core competence is a process of “business integration”: hotel chains need to integrate their know-how, knowledge and existing competence together (Overmeer, 1997) and coordinate diverse production skills and integrate multiple streams of technology (Prahalad and Hamel, 1990). This is even more important for hotel chains that experience expansion by merger and acquisition; they should focus on their tangible and intangible resources, the identification and development of core competencies, and produce stronger competencies (Roberts & Shea, 1996).

2.6.5 Assessment of availability

Both hotel management companies and independent hotels need to evaluate the possible approaches in their respective circumstances during the course of hotel chain formation. Hotel management companies need to develop their core competencies to gain the organizational capability, management expertise, and corporate culture to run hotels, then to scan the environment to determine the most appropriate steps to attract independent hotels to form a chain. Independent hotels need to analyze the comparative advantages of joining hotel chains over staying independent, the benefit versus costs while joining a chain, the differences between

various chains, and so on. Through the affiliation between the hotel management companies and more individual hotels, and the integration of operation, the hotel chain could be formed, and based on the new capability of the organization the chain could expand to a larger scale.

Assessment during the course of hotel chain formation concerns a two-way communication from both the hotel management company to hotel and hotel to the hotel management company. The major criteria for a hotel management company to evaluate a hotel include: location, previous performance, and assets. The major criteria for an independent hotel to evaluate a hotel chain and decide which flag to fly include brand, management style, technology, and supporting system.

2.6.6 Form of alliance

Transaction cost theory, which indicates that any business transaction bears the costs of negotiating, monitoring, and enforcing contracts with external parties and the cost of that coordination (Williamson, 1975; Hill and Kim, 1988; Jarillo & Stevenson, 1991), is very useful to analyze and compare different types of hotel chain expansion. Different ways of expansion will generate various costs and a hotel chain needs to analyze the costs of different instruments and decide the most economical way to expand business to other places.

Yu (1999) summarized six modes to expand to a new geographic scope: sole ownership, joint venture, franchising, management contract, strategic alliance, and consortia; but more approaches can be added e.g. leasing, merger/acquisition. Among these modes, according to the degree of equity involvement, they can be

divided into three categories: full equity involvement, minority equity involvement and non-equity involvement (Zhao & Olsen, 1997). Hotel chains are different in their expansion strategies: some rely on management contracts, while others may emphasize franchising or a mixed portfolio of several modes (Go et al., 1990). The way to expand is determined by the maturity of the lodging market, economic and transportation infrastructures, tourism related demand factors, sharing technological services, gateway and commercial center locations of potential projects, and the value of intangible assets of both parties, the customer and competitor factors, the partner's capabilities and personnel (Zhao & Olsen, 1997). The available instruments of expansion are discussed below as: direct investment, merger/acquisition, management contract, franchise, consortia and referral systems.

2.6.6.1 Direct investment

The availability of finance is the main external influence on the rate of growth. Firms have three main ways of financing investment and hence growth: retaining profits, borrowing, and issuing new shares. These three ways have respective conditions. The ability of borrowing depends on the firm's expected profitability, the amount of debt the firm has already raised compared with other sources of finance which may raise the risks to both borrowers and lenders. A new share issue depends on the stock market's expectations of the profitability of projects financed by the new share issue. The extent to which profits can be retained for investment within the firm is influenced by the expectations regarding the relative profitability of additional investment.

As hotel projects are capital-intensive, at the early stage of hotel chain development, most companies employ direct investment to build hotels and operate them to form a chain. The huge investment for hotel construction forced hotel companies into the financial market to raise money. The most direct way to raise money was a bank loan, but this might leave hotel chains with a heavy debt burden. More hotels then changed to the stock market to raise funds. Since Hilton was listed on the New York Stock Exchange in 1947 as the first hotel company (Gee, 1994), more and more hotel companies went public to fund expansion. For instance, Club Mediteranee became a public company with its shares being not only quoted in Paris, but also on the Brussels, and Luxembourg exchanges (Kartun, 1981). In China many organizations started to invest in hotels by raising money from banks, institutional investors or through the market and then duplicated their names and management to the new projects to form a chain. Financial tools played an important role in catalyzing the chain's growth, especially when hotel companies transfer from daily operation to more skillful asset management.

2.6.6.2 Merger/Acquisition

Marris (1998) argues that why takeovers happen is due to differences in the value placed on firms by the existing owners of the firm and potential acquirers; if the stock market value of the firm falls below the value of the firm to outsiders, the firm will be taken over. The value of the firm to potential bidders will be greater than the stock market value if the firm considering making the acquisition believes that higher returns can be obtained from the victim firm's resources than are being shown under the existing management.

Mergers and acquisitions have increased in frequency and magnitude in the hotel industry and become a popular strategy, which leads to the formation of more new and powerful chains (Go et al., 1990; Rushmore, 1996). There have been many cases of merger and acquisition in the hotel industry. For example, Grand Metropolitan launched a series of acquisitions, mergers and takeovers between 1966 and 1972 and transformed the company from a medium sized group to a major industrial service chain with strong property assets (Stewart, 1984). This approach is employed by more and more hotel companies to form the bigger mega-chains, and is obviously driven by easier access to the capital market to raise the necessary money and the back of economies of scale. In 1997 Starwood Hotel and Resort acquired the Westin and Sheraton hotels chains to increase its 1996 stock of 75 hotels with 20,350 rooms to 653 hotels with 213, 238 rooms. During the same period Patriot American Hospitality bought several management companies and small brands and then merged with Wyndham Hotels and Resorts, giving them 241 hotels with 57,220 rooms. Patriot later bought the largest management company in the industry, Interstate, which itself had a portfolio of 223 hotels with 45,329 rooms (Hotels, 1998). But it is only after the effective post-merger and acquisition integration of the organization, operation and management, that the new body can achieve more financial and operational advantages (Nardozza, 1998). As merger/acquisition is based on the power of an existing hotel chain, it may not work when a chain is still in its infancy and relatively weak. In fact, in the Chinese hotel industry, merger or acquisition has seldom taken place. A significant acquisition, especially from the China perspective, was the US\$1 billion purchase by the Marriott International of the Renaissance Hotel Group, including the New World Hotels, which has a strong presence and a long history in China. However the lack of many existing chains in

China means there are very few potential targets for acquisition or merger (Pine, 2001).

2.6.6.3 Management contract

Since the separation between ownership and management, hotel owners have employed hotel management companies to assume full operational responsibility and to manage the property in a professional manner (Eyster, 1985). As the hotel management company can provide technical design assistance, uniform name, and management expertise to owners, and create a workable arrangement and beneficial mechanism between the owners and operators, management contract between owners and professional operators prevails in the hotel industry (Withiam, 1993; Gee, 1994). Management contract is a suitable method for expanding a chain without substantial investment or overhead expenses, and it has become the most often used form for chain expansion (Withiam, 1993). Hotel management contract has evolved in recent years toward a more balanced relationship in which the hotel owner and operators share the risks and rewards (Rushmore, 1996), which can encourage hotel management companies to provide more effective operations.

Management contract is a low cost and low risk expansion mode as it is not associated with high capital involvement in the capital-intensive hotel industry. This is the most common approach for international hotels expanding to China. For example, Holiday Inn's expansion in China is almost all by management contract.

2.6.6.4 Franchising

Franchising is one of the most important practices in the hotel industry as this business form can expand hotel chains quickly to vast geographic locations. By a franchising agreement, a hospitality company (franchiser) sells limited rights to another company or independent operator (franchisee) for the use of its brand name in selling certain standardized products and services, in return for basic payment and a share of the franchisee's profits (Khan, 1993).

Franchising brings about advantages and sets up a very good leverage between two parties - franchiser and franchisee. The franchiser offers the franchisee a package of operational know-how, including a successful operation system (product or service, trade mark, corporate image, and reservation system) and essential assistance (locating, financing, pre-opening preparation, equipment, training, management and techniques), which brings the franchisee easier market access, lower cost of bulk purchasing and economies of scale, and the benefits of shared massive advertising campaigns, research and development, and problem solving mechanism in the network (Hall & Dixon, 1988; Mendelsohn & Bynoe, 1995; Brown & Dev, 1997). Through franchising, a franchiser can fulfill rapid and enormous expansion with limited resources, enjoy early entry into a market and establish a larger market share and higher revenue from the franchisee, and strengthen its position in the market, while reducing the risk of exploitation on a shared base of the franchisees.

Franchising, acting as a bridge between the partners (franchiser and franchisee), may be a more rational and fair mechanism for all parties, which makes this form an effective and favorable way of expansion. However, changing from a hotel

management company to being a franchiser needs a better than average operating system and market position (Ingram, 1996), which is not within the capability of all the hotel companies. This form is seldom used in Chinese hotels, due to the lack of capability of the indigenous hotel management companies. The forecast massive future increases in both inbound and domestic tourists in China presents a great opportunity for franchising of hotels, especially at the mid-market level or below and budget levels, which is where the great volumes of business will be available from both domestic and future inbound tourists. The opportunities exist, but a full understanding of China's peculiar business, social, cultural, economic and political context is essential for foreign companies to succeed, whilst existing and new indigenous companies require greater technical and operating expertise along with the necessary business acumen to operate hotel chains (Pine, Zhang & Qi, 2000).

2.6.6.5 Consortia

A hotel consortium has been defined as an organization of hotels that combine resources in order to establish joint purchasing or trading arrangements and operate marketing services (Litteljohn, 1982, pp.79-91). It is easier to form consortia, as it does not require asset involvement or strict uniformity of hotels. The two earliest hotel chains in China were formed by consortia, but failed to grow. It is argued that the lack of strategic control over member hotels, the inability to optimize structure and processes and gain cost advantages, or operational cohesion, as well as the strategic diversity of members, may question the viability and the collective effectiveness of this kind of organization (Roper, 1995).

2.6.6.6 Referral systems

The referral system is a kind of loose organizations among hotels, which can be easily sponsored but it is less effective to build a tight linkage among its member hotels. Ingram (1996) attributed the weakness of the referral system to the higher transaction costs of this kind of organization, as it has more multiple-owned units than other forms of chains, as well as the complicated decision making and different alternatives of the system.

2.6.7 Management and operation

Expansion does not take place automatically; on the contrary, its composition and implementation must be planned, especially at a strategic level. The creation of an optimum plan for expansion requires that the resources available to a firm, whether already acquired by the firm or obtainable in the market, be used to the best advantages.

Strategic management was primarily about selecting a particular strategy, and then deciding how best to implement it to attain the goals of the organization (Porter, 1980). Porter identified three potentially successful generic strategic approaches to out-performing other firms in an industry: cost leadership through establishing a low cost position; differentiation within an industry; or conversely to gain distinction within a particular segment of market. The strategies can be pursued by different hotel chains with economies of scale, segmentation, branding, and market diversification.

Chon and Olsen (1990) emphasize the adoption of strategic management in the hospitality industry and shifting hotel managers from operational to more strategic thinking. This is particularly important to hotel chains, as strategic management can be seen at three levels: corporate, business, and operational (Mintzberg, 1994). In hotel chain development, the strategy formulation focused most on the corporate level and the need for a more strategic way of thinking.

The appropriate strategy shapes the development of a hotel chain. As in the case of Grand Metropolitan Hotels, after an acquisition in 1979, the chain was led towards strategic planning and management on competitive analysis, major environmental trends and market understanding, and was not only opportunistic decision-making (Stewart, 1996), which brought greater success of expansion for the company.

Strategic management consists of four basic elements or steps: environmental scanning, strategy formulation, strategy choice, and strategy implementation (Porter, 1980). A firm's strategic plan was designed specifically to provide actions or initiatives enabling the business to take advantage of certain opportunities, or insulate itself in regards to a particular threat (Porter, 1980). Most international hotel chains have worldwide market position, economies of scale and scope, and network advantages. While the problem for their strategy formulation is emphasized on too few competitive attributes (Olsen, 1991). The strategy for distinctive and durable advantage will rely on the ability to learn faster than rivals, sensitivity to market trends, responding creatively to new opportunities and threats, and exploiting new ideas in a rapid and efficient manner (Horsburgh, 1991). Hotel chains at the initial

stage in a new rising market still need to start from the basic strategy formulation as conglomeration, differentiation and segmentation.

Chapter 3 Methodology

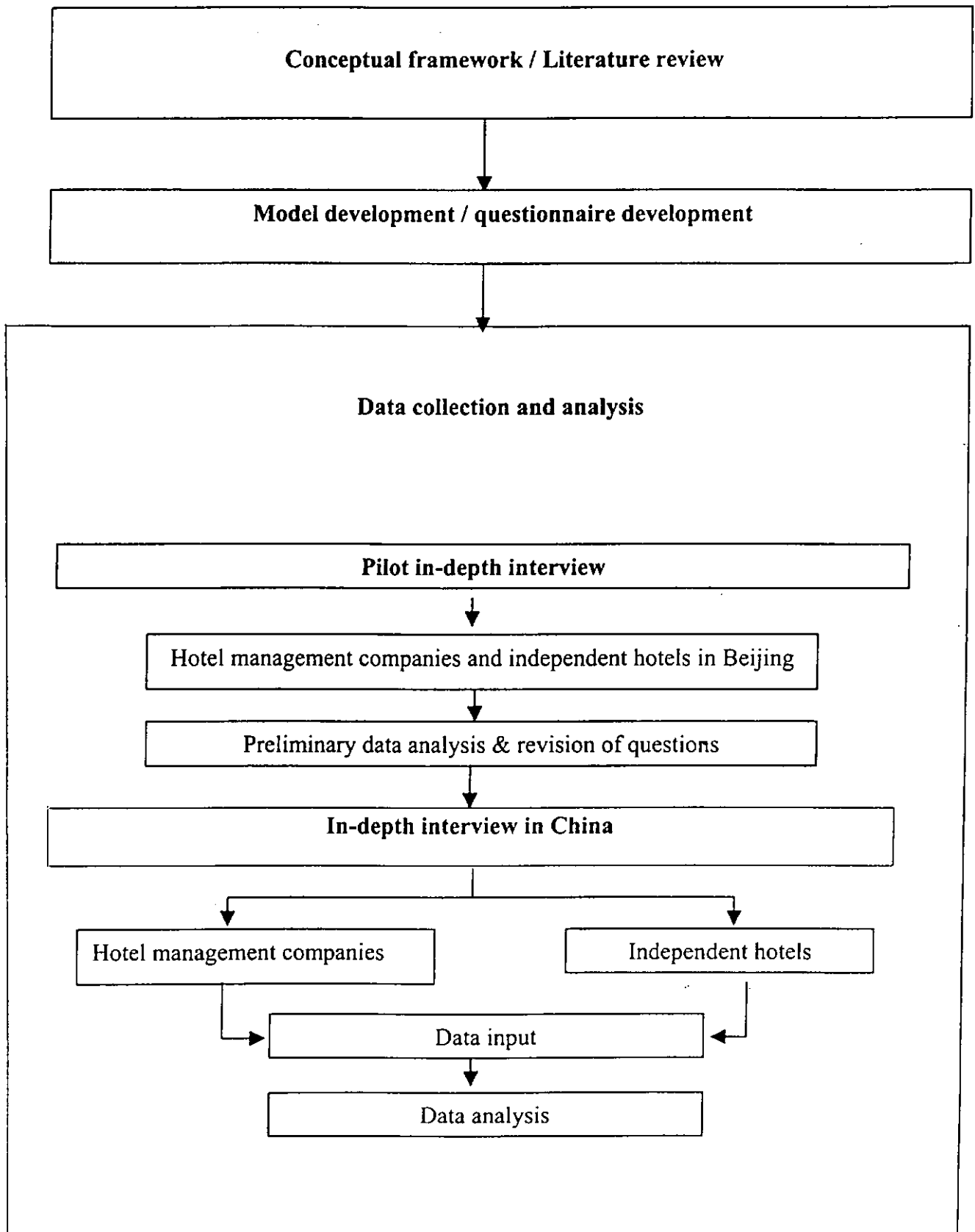
To meet the criteria for research - credibility, transferability, dependability, and confirmability (Ryan, 1995), given the exploratory nature of this research, a systematic data gathering, coding and analyzing method is deployed to describe and explore the hotel chain formation and expansion in China.

3.1 Research design

3.1.1 Three phases of study

The research is undertaken in three-phase steps. First, the conceptual framework for the study was stated in chapter 2. The formation of a hotel chain concerns two parties – hotel management companies and individual hotels. As hotel management companies played the core role in the course of hotel chain development, the conceptual framework concerns the growth and expansion of hotel management company based on the theory of growth of an organization and the nature of hotel chains. Based on this conceptual framework, a literature review was developed in two parts; the first part was used to understand the general concepts of hotel chain, and the second part to investigate hotel development in China itself. Second, based on the literature review, a model of hotel chain formation was developed to illustrate the sequence and factors of hotel chain development in China. The model identified various points where problems might occur, and research questions were developed to address these points so that in the third phase, the primary data could be collected to further explore hotel chain formation in China and examine the application of the model in the context of China (figure 2).

Figure 2. Research framework



3.1.2 Qualitative method

This research will use qualitative method to investigate the existing situation of the hotel industry and hotel chain operation; and at the primary data stage the case study approach will be deployed to examine several hotel chains in China and the model of hotel chain formation in China. Given the descriptive and exploratory nature of this research, qualitative methodology is more appropriate to be adopted as it is an approach that emphasizes processes and meanings that are not rigorously examined or measured in terms of quantity, amount, intensity, or frequency, and it seeks to answer questions that stress how social experience is created and given (Denzin & Lincoln, 1994). Qualitative research can probe deeply, uncovering subtle and complex issues using small sample sizes (Jones & Lee-Ross, 1998) and can take a more flexible approach, adapting questions to the data as the research proceeds. Qualitative method provides a partial view of a population, rather than a broad and truly representative one, but it can achieve a much deeper portrayal of individuals' feelings, attitudes and behavior. Qualitative method may seem less structured than quantitative techniques; this does not mean it is less effective or that less planning is involved. Qualitative research techniques tend to be more adaptable and flexible under practical organizational conditions.

3.2 Data collection

3.2.1 Research instruments

The research instrument in this phase is in-depth interview. Open-ended questions and some close-ended questions related to hotel chains and independent hotels were used during interviews to obtain extensive insights into hotel chain formation and

expansion in China. Of all the qualitative methods, in-depth interview is the most powerful tool to gain insights into the socially constructed realities of individuals (Kvale 1983; McCracken 1988). By using the in-depth interview, the interviewees are introduced to the topic through general oriented questions, through probing and prompting of interviewees for deeper descriptions (Howe, 1985), the interviewer can understand hotel chain formation and development in China from the respondent's perspectives and then interpret them for contextualization.

3.2.2 Data collection

3.2.2.1 Pilot in-depth interview

A pilot interview was first conducted in April 1999 in Beijing with several hotel managers to get the basic information about chain operation and examine the relevant interview questions, which were further developed later. The following organizations were selected for interviews: China Travel Service Hotel Company; Bass Hotels & Resorts China; Oriental Hotel Management Company; Intec Group; Kempinski Hotel; Hademen Hotel, and Department of Industry Management of China National Tourism Administration. The profiles of these organizations are attached as appendix B. The major consideration in selection of these organizations is to cover various type of hotels and companies in terms of their ownership, size, history, business, state-owned and foreign companies, hotel management companies and individual hotels, government regulators and industry practitioners, old and newly established companies, and high star hotels and low star hotels. This variety represents a more comprehensive picture of the real situation in the hotel industry in China. These questions are attached as Appendix A. After the pilot in-depth

interview, some issues in the literature review were re-examined and the questions were further developed for the next stage research.

The interview questions are designed in two groups for hotel companies and independent hotel respectively. Questions for Hotel Management Companies are:

1. Can you briefly describe the historical development of your hotel management company?
2. How about the current situation of your hotel management company in terms of (a) size; (b); speed of expansion; (c) performance?
3. What drives your company to expand and grow, from both the internal and external?
4. Do you scan business environment when expanding? If do, what factors influence the growth and expansion of your hotel management company?
5. Which kind of way do you use to expand e.g. direct investment, merger/acquisition, management contract, franchising, consortia, referral system, or any other? Why do you use that form?
6. How do you operate and manage your hotel management company?
7. How do you manage the hotels in the chain?
8. What are the factors influencing the expansion and growth of your company?
9. What is the future development plan and strategy of your company?

Questions 1 and 2 aim to get the basic information about the hotel management company and the background information about the organization and its environment. Question 3 tries to reveal the internal and external pressure the hotel management faced in the market. Question 4 aims to examine the environmental

scan of the hotel management company. Question 5 aims to describe the forms of chain formation by the hotel management company. Question 6 and 7 try to examine the management and operation issues of the hotel management company and the development of its organizational capability. Questions 8 and 9 further explore the environment, capability and operation issues of the hotel management company.

Questions for independent hotels are:

1. Would you please briefly describe you hotel in terms of its history, investment, facilities and performance?
2. How is the business environment of your hotel, from both the internal and external?
3. Are you willing to join a hotel chain? Why or Why not?
4. How do you compare the differences between chain-operated hotels and independent hotels?
5. What are the major considerations in joining chain operation?
6. If go chain-operation, what factors will you consider to choose a hotel management company?
7. Which kind of way will you choose to join a chain e.g. direct investment, merger/acquisition, management, franchise, consortia, and referral system? Why?
8. What are the emerging issues in the operation and management to a hotel after joining a chain?
9. What are the factors influencing an independent hotel to join a chain?
10. What is the plan or strategy for your hotel's future development?

Questions 1 aims to get the background information of the hotel; Question 2 and 3 tries to describe both the internal and the external pressure the hotel faced in the market; Question 4 and 5 aim to discuss the assessment of availability of chain operation; Question 6 and 7 try to examine the forms of chain formation from the point view of independent hotels; Question 8 and 9 aim to examine the management and operation issues during the course of chain formation; Question 10 further discuss the related environment and management issues of the hotel.

3.2.2.2 In-depth interview

Unstructured or in-depth interviewing is the qualitative technique used for gathering data in this research. Information elicited through interview or conversation is usually practical and can be used immediately. One of the reasons for this is that an analytical framework for hotel chain development has not been well established before. The free format of questions makes it possible to gather straightforward and valuable comments from interviewees directly. This makes it possible to identify issues that are important to the interviewee but unforeseen by the interviewer. In-depth interviews are guided conversation, in which the researcher and interviewees focus on specific topic areas, reduce the distraction and may also improve communication. Interviewees are more willing to reveal details about their organization, providing the researcher with information about the facts and problems, and may give interviewee's insights into the researchers' perceptions. The free response could also enable the informant to discuss issues or add anything important and provide a high level of contextual understanding. Given the nature of this research, in-depth interview is the appropriate technique for data collection. The in-depth interviews were conducted in Beijing, Shanghai and Guangzhou in August

2000. Interview questions for hotel management companies and hotels are attached as Appendix C.

3.2.2.2.1 Interview with hotel management companies

Nine hotel companies and one tourism administration in the gateway cities of Beijing, Shanghai, and Guangzhou in China were selected for interview. These three cities are the earliest to start the modern hotel industry in China and have a relatively higher standard of development. More importantly, most hotel chains are headquartered in these three cities and use them as a base for expansion. The criteria of selection of companies are their size, portfolio of hotels operated, location, management style, ownership etc. to make sure all the possible type of hotel management companies are included.

The selected hotel companies for interview are:

1. Beijing

Gloria Hotel Management Company;

Jianguo Hotel Management Co. Ltd.;

Sheraton Hotels & Resorts, China

Tianhong Real Estate Development Company

2. Shanghai

Jinjiang Group

Jinjiang Hotel Development Company

Xinya (Group) Hotel Management Company

Xingu Hotel Management Company

3. Guangzhou

White Swan Hotel and Management Company

Guangdong Provincial Tourism Administration

3.2.2.2.2 Interview with independent hotels

Among the three cities each has more than one hundred hotels, with most independently operated. Several hotels in each city were selected for in-depth interview to explore the major factors and problems of independent hotels joining hotel chains. The major consideration to select hotels were their star level, ownership, location, business type, history, and if possible to cover all types of hotels. These hotels include:

1. Beijing

Xijiao Hotel

Prime Hotel

2. Shanghai

City Hotel;

Bailemen Hotel;

3. Guangzhou

Garden Hotel

Guangdong International Hotel

Huaxia Hotel

Liuhua Hotel

Gitic Riverside Hotel

3.3 Data analysis

A total of 26 in-depth interviews were conducted to examine the situation of hotel chain development in China and obtain insights into the various aspects of hotel chain formation. Among them 2 are from tourism administrations, 14 from hotel companies and 10 from independent hotels. Of the 20 interviewees, 13 are in Beijing, 6 in Shanghai and 7 in Guangzhou. Among them two are MNHC branches in China, others are all state-owned hotels and companies. The interviews are grouped with hotel management companies, independent hotels and tourism administrations to examine the views of different groups on the research questions.

Qualitative data are generally complex and highly dependent upon the timing and circumstances under which they are gathered, before analysis and usage, the data are coded to ensure that the data are managed methodically, and that the researcher can access all the material they contain. Phenomenological basis of qualitative analysis requires the researcher to validate qualitative findings as rigorously as possible and draw hypotheses from qualitative data to build theory. Then it is necessary to go through data in detail, picking out elements from which theory can be constructed. The phenomenological approach was taken to analyze the interviews. First all the interview transcripts were translated from Chinese into English. Relevant elements were sorted into types, coded and indexed, then the transcripts were read and re-read to discover the structure of the phenomenon till the themes emerged according to the approach detailed by Masberg & Silverman (1996).

Data analysis is carried out in line with the objectives of this research and the model developed in the literature review. The objectives of this research are to explain the

historical context in which hotels have developed in China; to describe and evaluate the current hotel industry in China; to investigate the existing situation of chain-operation in China's hotel industry; to assess the necessity of the indigenous hotel chain development in China; to assess the viability of the indigenous hotel chain; and, to recommend measures to assist in Chinese hotel chain development. A review of the hotel industry in China is already conducted to cover the historic growth, structure, regional distribution, foreign participation, and hotel chain development in China. Comparison of the performance between independent hotels and chain hotels, different types of chain hotels, indigenous hotel chains and international hotel chains are also made to find out the relative advantages and disadvantages of each type of hotel. The analysis is intended to illustrate the situation of hotel chain operation in China.

Content analysis is used to analyze the text of the interviews. The data collected was coded as nodes and structured to an index tree. Through this dissection and synthesis process, the results and findings emerged to fit into the model developed in the literature review chapter. Content analysis is carried out on two groups—hotel management companies and independent hotels. Data from hotel management companies generate the results on domains of market, environment, competence, availability, management and operation. Data from independent hotels mainly reflect their concern on hotel market, business environment, availability and the relationship with hotel management companies. Generally, the content analysis extracts five main issues of the hotel chain formation: market analysis, environment analysis, competence analysis, relationship analysis, and other relevant issues, which further

illustrates the model of hotel chain formation and its application in China's hotel industry.

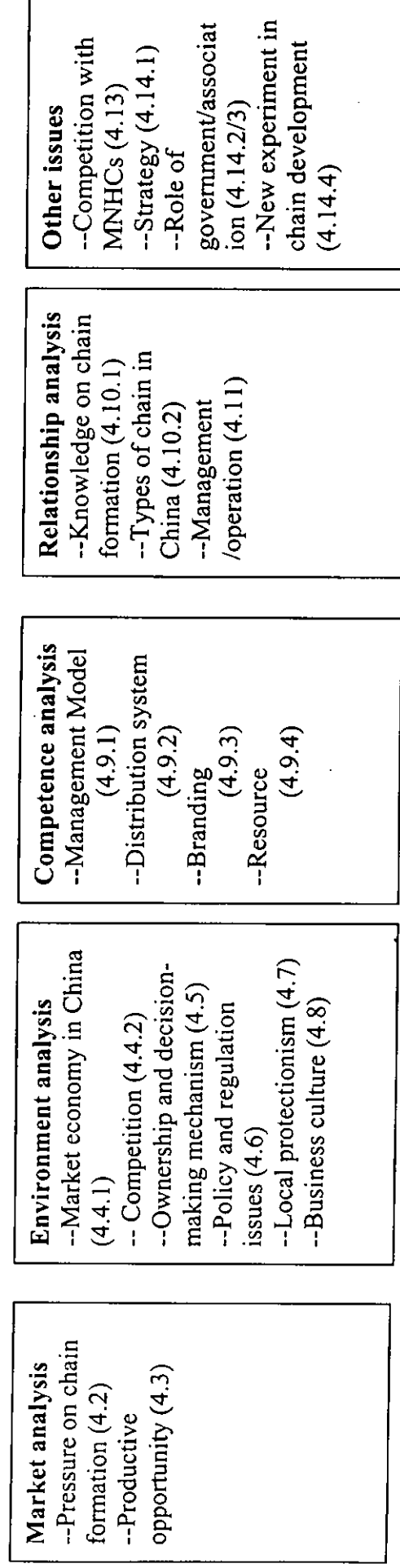
Chapter 4 Results & Findings

4.1 Outline of results and findings

The objectives of this research are to (1) explain the historical context in which hotels have developed in China; (2) to describe and evaluate the current hotel industry in China; (3) to investigate the existing situation of chain-operation in China's hotel industry; (4) to assess the necessity and the viability of indigenous hotel chain development in China (Including identification of major environment and management issues and major barriers concerning hotel chain development and expansion in China; (5) to develop a model of hotel chains development and apply it to examine the hotel chain development in a China context; and (6) to recommend possible measures to assist in Chinese hotel chain development. Through literature review, the historical and existing situation of hotel chain development in China was examined and described. The results and findings of the data collected mainly concern the model developed and its application in the context of China, which was sketched below in five areas (figure 3).

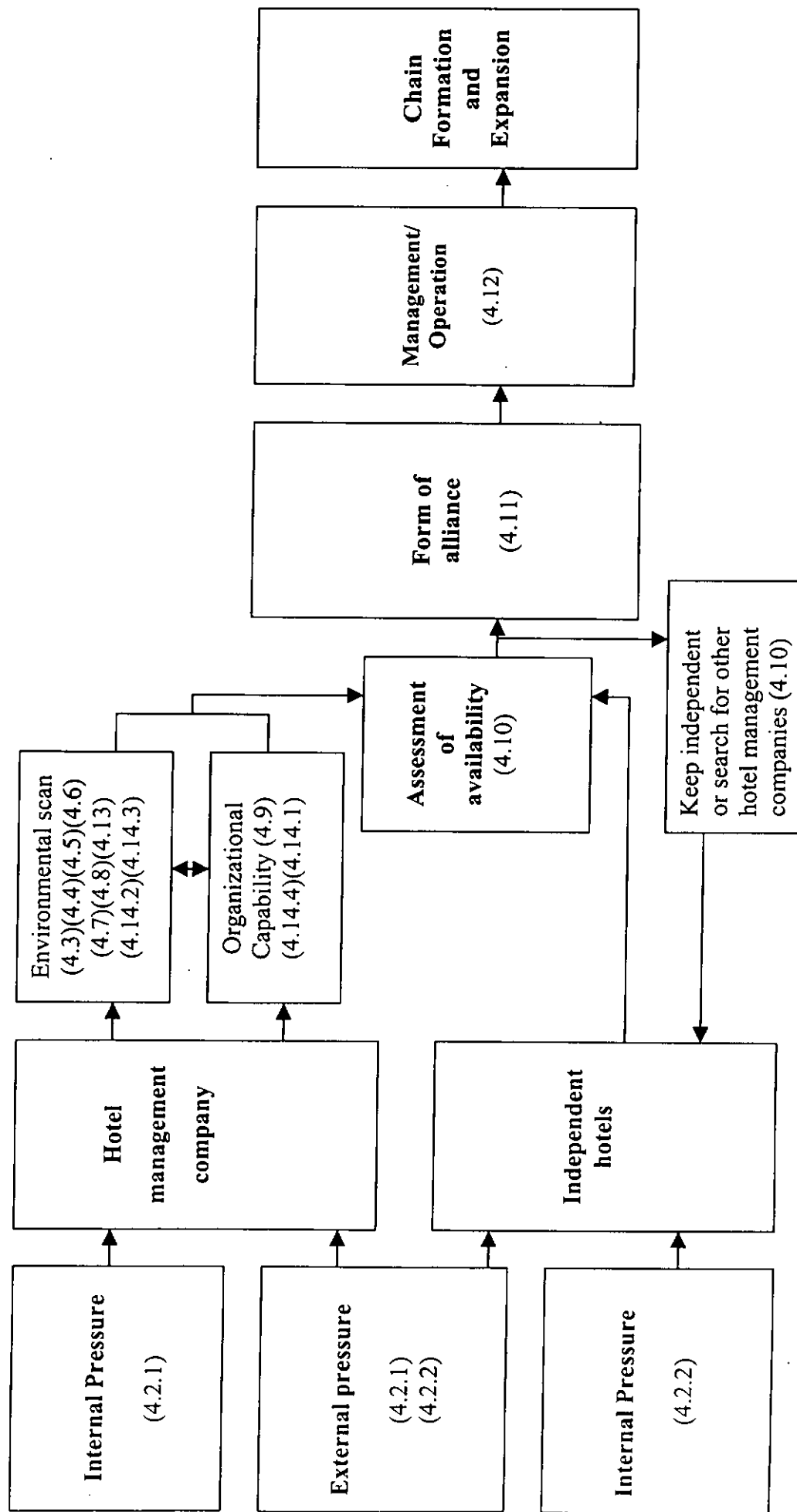
Figure 3. Results and findings of primary data

(Relevant text section numbers are indicated in the figure)



The model created in chapter 2 (figure 1, p53) was an attempt to provide the theoretical constituents / issues which influence chain formation in China. The results of the research support many of these issues directly, but also raise new issues. Figure 4 attempts to show the connections between the theoretical model and the results of the research - chapter 4. Section numbers are added to the figure to demonstrate these connections. The results and findings are elaborated in the following context. It should be noted that all opinions and comments made throughout chapter 4 are those of the respondents, not the personal opinion of the researcher.

Figure 4. Connection between the results/findings and the model
(Relevant text section numbers are indicated in the figure)



4.2 Pressure on chain formation

4.2.1 Pressure on hotel management companies

To manage other hotels is a new source of profit for hotel companies. It is found that generally hotel management companies have a higher profit rate than hotels, which is the main reason for hotel companies to expand and recruit more hotels. Generally hotel management companies manage hotels with a package of expertise and know-how, but do not need to invest much money. MNHCs got quite good profit from Chinese hotels especially at the early year of hotel development when the management fees were very high, possibly 5% of GOP plus 5% of profit.

Geographic diversification is another major consideration for hotel chain creation. Some hotel companies worry about too much reliance of business in a single area. For example, the Beijing Jianguo Hotel Management Company and the Shanghai Xinya Group are eager to seek opportunities outside of Beijing and Shanghai. Another important reason is human resource - hotel companies' expansion enables them to place and train the hotel personnel and offer opportunities for the young management team. In addition, hotel companies can also increase their exposure and market awareness of their brand as managing more hotels and exporting the management will increase the fame of the base hotels.

It is interesting to find that some hotel companies are not so aggressive or motivated to expand. This is especially true for those hotel management companies that have been created on the basis of one core hotel. Those hotel management companies under big hotels did not work very hard to explore the market, but focus more on the

operation of the base hotel. They do not have a specific team, like foreign hotel management companies to penetrate the market. Hotel management is just a byproduct, and not so much capital, human and other resources are invested in expansion actively.

4.2.2 Pressure on independent hotels

A very clear concept among Chinese hoteliers is that hotels cannot get government subsidy as in the early 80s and need to gain profit to survive by themselves. Performance is the first consideration for independent hotels to join a chain.

There are more negative forces for independent hotels to seek chain operation. The first is the mentality of the investors. From the very beginning of hotel construction, few hotel investors in China are business driven because most hotels are invested by government. To some hotels invested by government agencies, the previous purpose of building is not a market-leading economic motivation, but for the convenience of conference and reception activities. Contracting to a management company will not be convenient as the procedures, standards and payments are contradictory to the owners needs. Though most of the state-owned enterprises are split out from the government agencies, most hotels or guesthouses were not, as most of them needed to play an internal service role. The right of control, emotional and other reasons will influence the operation of the hotel management company. Another factor is the interest group in the hotel that can benefit from internal hotel operation, especially hotels invested by government bodies. If contracted to another party, it is not convenient for the members of the interest group. They do not want to give out the right of control. In China, hotels are not completely operated by professionals: hotel

management people are considered to be “officers” who cannot be replaced by people from the outside institutes.

Some hotels hire a professional general manager instead of a management company. Though the general manager can play a more professional role in management, there are still big differences between a general manager and a whole management team from a management company. For an independent hotel manager to make a decision, he will start from market investigation and adaptation, get information and refine it to make a decision, then implement, supervise, and revise it. In chain hotels decisions are made by a group, which may influence the whole market as the hotel chain has many hotels in the pool and rich information for a decision. Hiring a management company is a relationship between two firms; the hotel management company has more power than an individual general manager. When a hotel hires a general manager to organize a management team, it is more of a personal relationship and difficult to handle in the Chinese mechanism.

4.3 Productive opportunity

Why did hotel chains emerge in China and MNHCs enter China? According to Penrose's (1995) model of firm growth and expansion, there exists ‘productive opportunities’ for those firms to create product or provide services in the market. Generally the hotel chain development in China has great “productive opportunities” through “environmental scan” as evidenced by the booming tourism industry and the increasing supply of hotel rooms along with the lack of essential management expertise and resources.

4.3.1 Lack of management expertise and technology

At the early stage of the hotel development in China, hotels lacked management expertise and technologies, which provided great productive opportunities for MNHCs. Among China's 5,786 hotels in 1999, only about half were star-rated, revealing that the management level in the hotel industry had big potential to improve when many hotels needed professional management, which provided great opportunities for hotel management companies. After 20 years development, the hotel industry in China has a stock of the necessary human resources and management expertise. Once integrated, hotel chains can be formed and expanded on this base. With the reform toward a market economy, the state-owned hotels also need to improve performance and consider chain formation as a possible way to achieve this goal. First, the enterprises under government agencies are split out and have no way to get government subsidy anymore. Second, hotels need to earn more money to support the expenses of upper level owners and research more on market, capital and opportunities, though previously they paid more attention to the needs of the upper level leaders and relied more on their decisions in a planned economy system.

4.3.2 Supply of hotels

In recent years the overbuilding of hotels in China provided even more opportunities for MNHCs as many poor performance hotels were looking for good hotel management companies. For example, several years ago Holiday Inn only recruited one hotel per year, but now the company can sign contracts for four or five hotels every year and expand faster. The change of the hotel industry has a very strong impact on hotel management companies. Real estate and office buildings have been

transformed into hotels, even some government function buildings e.g. training centers of the central government departments have turned into hotels. The inflow of the investment into the hotel sector cannot be effectively monitored and controlled.

4.3.3 High-class hotels vs. economy hotels

In recent years the productive opportunities may change, as management of high-class hotels was almost all taken by MNHCs and competition becomes fiercer at that end. With the development of massive domestic tourism, the demand for accommodation facilities catering to domestic travelers has increased and the economy and budget hotel sector will mushroom.

Most hotel management companies have plans for this market sector, or are looking at it. With a view to the potential of domestic tourism, Jinjiang Group invested in this market. The company found that there was an imbalance in hotel structure in Shanghai with too many high star hotels but a lack of affordable products for newly affluent domestic travelers, the company targeted the market sector and set up a new company to develop economy and budget hotels. Thus Jinjiang Star Inn was designed as a new hotel product at affordable price for mass tourists in China and achieved great success.

Xinya Group also tried the economy hotel sector through its Xinya Star brand. It used bank loan to renovate an old hotel property, which now has average occupancy rates of 90%. Xinya is looking favorably at this market sector and will improve and expand through retention of profit, bank loan and issuing stocks.

Gloria will set up a new company to develop economy hotels below three-star. Previously the hotel company only did business for three-star hotels and above. The lower market segment has great potential in the next decade as most holiday spenders and weekend travelers in China stayed in two-star hotels. The company will develop a chain to satisfy the domestic travelers. However, it will not directly invest in new hotels, but offer financial assistance for hotel renovation, then manage them. The product of this chain will be a standardized clean room, simple utilities, express service, and a Chinese restaurant for all tastes, catering to domestic guests for pleasure, convention and business. Geographically, Gloria will look more to the west part of China, e.g. Guizhou and Shaanxi, as chain operation is seldom found there and good opportunities are expected.

Many low star hotels in north Guangdong province have appeared in recent years, most two-star level because it is found that hotels in Guangdong province are imbalanced in terms of product category. Motels and resorts are increasing, but most hotels are designed according to the standard of higher category business hotels. Guangdong Tourism Administration initiated a campaign called “Cantonese tour Canton” to promote intra-province tourism. Later another campaign called “Chinese tour Canton” was sponsored to promote domestic tourism to Guangdong. To improve the accommodation for economy travelers, Guangdong Tourism Administration introduced Youth Hostels to better serve economy and budget travelers.

Many foreign hotel companies are also looking at the budget hotel sector and have ambitious plans to develop in this market segment through chain operation. For

example, Starwood Hotels & Resorts has an economy hotel brand, Four Point, which will expand rapidly in the Asia Pacific region, including China. However there are different views on this market sector, the argument is about cost effectiveness of investment. Compared with the low star hotels of foreign countries, this kind of hotel in China has too many problems. Business environment in this section is not good, as most low star hotels are renovated from former “Zhao Dai Suo” (small inn) with high cost and low room rate. If investing in new low star hotels, it is difficult to choose good locations. If the hotel is built in a good place, the cost will rise marginally. Some industry people think it is not worth investing in budget hotels, as people doubt that they can make money. The budget hotels are not desired to be rated as two-star as hotel investors think it is not a high class. This is the inclination of the private investors, as most investors are interested in high star hotels. Others consider that one- or two- star hotels have good operational performance, as they are very flexible in the market. The star level distribution in the hotel industry is a big argument. Traditionally most hoteliers in China have aimed at high star hotels, which leads to the oversupply of high star hotels. However, high star hotels are a minority part of the total market, most people in China are still below the middle class standard and emerging domestic tourists can only afford a medium price.

Most hotel developers look at three-star and above hotels, but ignore one- or two-star hotels, which was reasonable in the past because China’s tourism industry started and was dominated by inbound tourism. CNTA statistics and various reports showed that the highest profit rate was four- and five-star hotels and the performance of one- and two-star hotels in China is not satisfactory in terms of operation and management. As one Beijing interviewee revealed, the high-star sector was

supported by government from policy to management, such as the deduction of some tax since the emergence of inbound tourism in China. For example, in Beijing only managers of three-star and above hotels can attend industry conferences, while nobody looks at the low star hotels, speaks for them or helps them to solve problems, not to mention the lack of preferential policies.

However, an important point usually ignored is that high star hotels need more investment and input. At the initial stage there was no need to stress domestic tourism, but now it is changing as Chinese residents have time and money to travel. The increase of domestic tourism accounts for 70% of the whole tourism growth and the ratio of foreign guests will decrease. Now the GITIC Riverside Hotel in Guangzhou estimates 50% domestic guests, Huaxia and Baiyun Hotels also have a high ratio. Hotels in the US and Japan are also dominated by domestic travelers, and in the future this will be the trend in China. With the change of ideas of domestic people, more and more hotels will follow the direction of chain operation. If the domestic brands can rise, they will take their share of the market step by step.

The increase of the low star hotels for Chinese use provides opportunities and great potential for domestic hotel management companies because there is still distinction between low star hotels in China and overseas. Low star hotels in Beijing, Shanghai and Guangzhou are of international standards, while it is not the case in other parts of China.

4.3.4 New sectors - motel, hostel, resort and domestic traveler

In some places in China e.g. Dongguan in Guangdong province, motel style accommodation facilities have emerged. But some industry people think there exist particular problems to build accommodation facilities along highways in China because highways are monopoly operated by highway management companies, unless these highway companies develop hotels by themselves. It is very difficult for outsiders to get a piece of land from those highway companies.

Another area of interest to hotel companies is resort. Several years ago there were no resorts in China at all, but now resort projects have emerged and more and more are planned. One of Gloria's best performance hotels is its resort in Hainan Island. Bass Hotels & Resorts is also negotiating resort projects in some scenic areas in China as the company predicts that the tourism industry for Chinese people is just rising. The White Swan Hotel managed a small resort catering to weekend vacationers and conference participants, which has quite good business. The Zhuhai Resort Village opened some chain-operated resorts in Zhuhai. The coastline in Guangdong is the longest in China, but there are not many resorts in the coastal area. Many hotels in Guangdong do not invite management companies, but are managed by individual talents. Some small hotel management companies in Guangdong operate hotels in Guangzhou, Zhuhai and Foshan, but these companies are small in scale and do not have a strong brand in the market.

Even in the luxury hotel sector, domestic travelers are increasing marginally. Take the five-star White Swan Hotel for example, in 1999 domestic travelers accounted for 13% of its total market, in 2000 the share increased to 18%. Several years ago,

the hotel did not receive domestic guests, attributed first to the income of the domestic people, second, the restrictions on foreign currency exchange, and so on. In the Garden Hotel Guangzhou, domestic guests account for 20% of the total, and more attention is paid to the domestic market now. Even the MNHCs projected that the fast economic growth and the increased consumption of domestic people will generate a bigger growing domestic market. Bass projected 18% domestic guests for all its hotels in China in 2000 and predicted 20-23% in 2001.

Some hoteliers also attribute the emergence of resort and other types of hotels in China to the influence of modern technology, especially the growth of the computer network. With the maturity of the network, business travelers may be affected and business trips decrease but holiday travel will increase. Consequently the demand for commercial hotels will drop, while that for leisure hotels and resorts will increase. Hotel products and structure need to be adjusted, which means new opportunities for hotel expansion.

Generally, as an emerging market for chain operation, the opportunities for hotel chain expansion grow, but as more and more MNHCs entered China and the rise of more local hotel management companies, competition among hotel management companies becomes fiercer and the price war influences their performance and revenues.

4.4 *Environment Issues*

It is interesting to find that most hotel companies and hotels can feel a dramatic environment change in China from the macro level to the specific market. Some

hoteliers attribute the failure of chain formation in China mainly to the bad business environment. Constrains of environments also limited the development of capability of hotel management companies.

4.4.1 Market economy in China

Some hotel managers argue that it is impossible to run a mature hotel chain in an immature market, as China is in the transition from a planned economy to a market one. The basic market principles, like investors choosing managers, profit determining personnel income and market price determining revenue, cannot be implemented in China. The whole political mechanism and the relationship among people cannot create such an environment. During the course of commercialization, some traditional ideas and concepts have not completely changed in people's mind and it takes time to become a mature market when the whole system in China is in a process of reengineering. At present hotel chains can be initiated and established, but no mature chains can grow to a large scale.

4.4.2 Competition in the hotel industry

All the hotels interviewed showed serious concern about the increasing competition in the hotel industry and the desire to control the increase of new hotel rooms. As one interviewee described it "Competition becomes fiercer in recent years. Previously our annual occupancy rate was 90% and above. We didn't worry about business at that time. Now Beijing builds so many hotels, in addition with the opening of the Beijing West Railway Station, many guests divert to other hotels. Now our occupancy rate is only 70% and there is seasonality. Xinqiao Hotel, Jinlang

Hotel, The New World Hotel, and the Capital Hotel are all nearby, bringing in fierce competition. From 1997 we set up a sales department to struggle for tour group business, formerly we have overbooked independent tourists". The increasing competition in the hotel industry made more and more independent hotels look for ways to improve their position in the market.

4.5 Ownership and decision-making mechanism

4.5.1 Separation of management from ownership

One of the problems in hotel chain formation is the separation of management from ownership. This is quite difficult for Chinese hotels, especially most state-owned ones. State-owned hotels, if contracted to hotel management company, may get more revenue and profit, but may lose the right of control, power and some privileges such as personnel recruitment, free use of some hotel facilities. The privilege is more important to hotel managers and related government agencies as the hotel is not only expected to generate profit, but also other interests for these beneficiaries. This is related to the whole situation of the country. The properties are not operated as commercial business. For some private hotels, the owners may also not wish to lose the right of control. Jinjiang Group, as an owner, established an assets management company to deal with the assets of the group. The management is contracted to the Jinjiang International Management Company for operation. So the ownership and management in Jinjiang Group is separated. In Gloria Hotels the separation of management and ownership is quite explicit- the ownership of these hotels belongs to COFCO, and the Gloria Hotel Management Company operates and manages these

hotels for COFCO. Some companies need to be restructured to make this mechanism work effectively.

4.5.2 Complexity of the ownership

Hotels of the different government systems cannot unify according to the requirements of the hotel industry because each hotel has their own administrative power and is isolated from others. Hotel development is not market-oriented, but at a bureaucrat's will. Take Beijing for example, people do not even know how many departments and sectors are managing hotels and it is impossible to organize a hotel chain through assets affiliation because different ownership will generate different orders from different owners, and hotel owners think about things according to their own benefit, but not the principle of the market. Although hotel managers know what and how to do, hotel owners do not agree. Under such a mechanism and ownership system, it is very difficult for hotels to unify.

The complexity of the ownership system made hoteliers pessimistic about hotel chain formation in China. The complexity of the ownership is attributed to the particular history of China, which resulted in government intervention, mechanism problem, non-commercialization and fragmentation. Simply sending in a management team cannot solve all these problems and sometimes change also depends on the higher-level government officials or leaders.

4.5.3 Problems arising in state-owned hotels

There is a widely accepted opinion in the industry that state-owned enterprises will decrease owing to their dilemma of decision-making mechanism, as the ownership system made nobody responsible for the assets of the insolvent hotels.

4.5.3.1 Constraints on free flow of hotel assets

Though some hotels are losing money, given the inflexible state-ownership system, the hotel cannot be sold, as people will proclaim the “loss of the state assets”. Assets cannot flow freely, which severely confined the development of the industry, the ownership of hotels then can only be transferred among different government agencies as those agencies struggle for property rights for their own interests.

Dongfang Hotel Group is a stock hotel company with total assets of RMB 2.1 billion, issuing shares on the Shenzhen Stock Exchange. In recent years the hotel assets were transferred to different government agencies, first to Commerce Committee, then Service Bureau, now to a holding company -Yuexiu Group. The Liuhua Hotel in Guangzhou is also confused by the ownership and mechanism. This hotel previously belonged to Guangzhou Tourism Administration, but was transferred to the Guangzhou Catering Service Company in March 2000. In 1992 the hotel tried to reform to a stock company and went public, but failed owing to its small scale. Now the hotel faces trouble when the management team wants to invest in new hotels to form a hotel group and expand their business, because the hotel has no right to invest as its assets has already transferred to the Guangzhou Catering Service Company during the reform.

The White Swan Hotel belonged to Guangdong Provincial Tourism Administration, was transferred to Guangdong Tourism Group later. The Guangdong Provincial Government is going to restructure its tourism firms and set up several conglomerate companies. In the hotel sector, the government plans to conglomerate all its hotels to the White Swan Hotel Company. If the conglomerate company can be established, the board of directors will use the White Swan brand to raise capital through bank loan and issuing stocks and expand out of Guangdong through capital involvement, merger/acquisition, direct investment, or other ways.

4.5.3.2 Deficiency in the decision-making of state-owned hotels

Another constraint of state-owned enterprises is the mechanism in decision-making and adaptability to the market. As state-owned enterprises, hotels are ineffective in raising capital and improving management capabilities. The key problem is that there are too many administrators from the government agencies, which can intervene in the operation and management of hotels from various aspects. If a hotel company is a government asset, every government leader has a say in its business and the hotel company is in a dilemma about which way to go and needs to change frequently. The old mechanism still plays an important role in hotels and cannot be reformed completely.

In one state-owned hotel in Beijing, the Commercial Commission of Chongwen District administers the business and party affairs of the hotel. The Enterprises Committee of Chongwen District manages hotel managers, personnel and education in the party. The Commercial Commission is also in charge of pricing, business, marketing etc. Chongwen District Government controls wages. Renovation projects

need the approval of government, which needs to be discussed and decided in the District Party Meeting. A RMB 20 million bank loan also needs the support of the district government leaders to do some public relations with banks. There is still too much intervention from government agencies. Chongwen District established a State Assets Management Company to operate all the assets in this district and enforced it in 2000. The hotel hopes that the establishment of the State Assets Management Company can improve the administration.

4.5.3.3 Personnel management

Like other state-owned enterprises, Jinjiang faces the incomplete reform of the current employment mechanism. Though it is said that the most valuable asset of a hotel management company is human resource, the current mechanism of the state-owned enterprises cannot attract and retain human resources. Recruitment, appointment or removal, rewards or punishment of personnel in Jinjiang Group have not reached the standard of the market economy, but is often influenced by the Shanghai government's regulations on state-owned enterprises. For example, all general managers of Jinjiang Group are appointed by the government and their salaries are paid according to the standards of government officials' ranking. This kind of personnel management system is considered as a big barrier for Jinjiang Group's growth to a bigger company.

The inflexible human resources management system and the complicated relationship behind personnel could be attributed to the mechanism of the state-owned enterprises. Some hoteliers worry that after China's entry into WTO, talented

staff will flood to foreign companies as no one would like to work for a Chinese hotel management company with such a personnel system.

4.5.3.4 Withdrawal of state assets from the hotel industry

Recently the central government proposed that state-assets should retreat from the competitive industries and the hotel industry should also be reformed according to this policy and toward this direction. However it may be difficult to withdraw state assets from hotels because state-owned hotels are bases for public relations in all provinces and cities and involve too many interest groups. It will be very slow for all provinces and cities to deal with this issue.

Some hotel companies try other ways, like issuing stocks and going public. One subordinate company of Jinjiang - the New Jinjiang Hotel - issued stocks and now the Jinjiang Group itself is thinking about issuing stocks. Some hotel companies are restructuring assets and ownership system to streamline the operation and management. Oriental Hotel Management Company is a company under the Bank of China (BOC). BOC has more than one hundred hotels nationwide, which belongs to the BOC headquarters and regional branches. BOC set up an Oriental Assets Management Corporation and transferred all the hotel assets under BOC to this corporation. Then BOC set up the Oriental Hotel Management Company. According to the requirement of split of the management from ownership, all the hotels of the BOC branches should be contracted to the Oriental Hotel Management Company for professional management and the Oriental Hotel Management Company is responsible for daily operation and management of these hotels. The Oriental Hotel

Management Company has no right to deal with these hotel assets, and just fulfils its management under the director of board of those hotels.

In terms of the ownership of assets, hotels in the CTS system are also very complicated. The CTS system has 120 hotels in China, while ownership belonging to CTS Branches or Overseas Chinese Affairs Office at all levels. CTS Hotel Company holds shares in only 12 of these hotels. Though the other hotels are poor in performance and often seek assistance from the CTS Hotel Company for finance and favorable policies, the complication of ownership prevents those hotels joining together as a chain or group. CTS Hotel Company has to search for other ways to assist, such as introducing guests to them, providing advanced management expertise and expanding by branding. CTS Hotel Company is exploring a change of assets structure of its hotels to optimize them through changing the stakeholders, for example, employee stockholding program, inviting more shareholders, and change of sole state-owned hotels to limited liability companies.

Some independent hotels are seeking ways to reform from a sole state ownership to a limited liability company. Xijiao Hotel belongs to the Ministry of Coal Industry, after several years' reform it has been changed to a limited liability company with five shareholders, which are five mining companies in China.

4.5.3.5 Private involvement in hotel chains

Until now there are no real private hotel management companies in China. There maybe some hotel management consulting firms, but they are very small in scale. There exist private independent hotels in China. However, the problem for private

hotels is that the market concept of private owners is even more backward than state-owned hotels. Most private enterprises are managed in a family style, not by professional managers.

It is quite interesting to find that most hotel management companies would like to manage state-owned hotels rather than private hotels because the management companies think that most of the private hotel owners are incompetent and easy to overthrow the contract once they are not satisfied. In addition, they place too many henchmen in hotels and have too many privileges there. Many private enterprises have not established mature, modern enterprise systems. However, state-owned enterprises are big units, and follow the rules set by the government. Hotel management companies are aware of the rules and obey the rules. It is easy to communicate and solve disputes according to the rules, and there is stability in all aspects of business. It is easier to negotiate with state-owned hotels, as both hotel management companies and the independent hotel are state-owned. The difficulty to deal with private hotels is their inconsistency. Another problem revealed in private hotels is that hotel owners may not comply with the standards of hotel management companies and do not authorize management fully to the management company. Sometimes hotel owners terminate the contract without any reason.

4.6 Policy and regulation issues

4.6.1 Legal framework

Several hotel management companies feel that the lack of available laws caused disputes in hotel management as the incomplete legal system cannot protect hotel

management companies, especially intellectual property rights. Bass Hotels & Resorts engaged in a lawsuit with a company on the registration of its trademark - Crown Plaza. Jinjiang also feels that the incomplete legal system cannot protect hotel management companies, which were often driven out by hotel owners. Sometimes people do not obey business norms and business morality, and business is not protected by law.

The incomplete legal system may also influence the quality of management and the adoption of some business forms. For example, there is no legislation on franchising in China. Bass operates in China completely by management contracts, no franchising. The hotel owner has the power to participate in the management and has a high degree of intervention ability. If a hotel management company grows up and internationalizes, and does not desire to sign a management contract but prefers to franchise, it is very difficult to franchise in China, and will not start in the near future.

Chinese hotel management companies are more constrained by human relationships or personal contacts with independent hotels. The simple case is that a hotel company signs a contract with an independent hotel and subsequently manages the hotel very well. Once the leader or the investor of the hotel changes, the new leader may terminate the contract without any reason. Contracts in China are based more on personal contacts, but not on a sound legal system.

Some hoteliers call for legislation by government or regulations by CNTA to protect the benefits of both hotels and hotel management companies and coordinate their relationship to avoid contradiction or dispute. If the legislation is not completed, the

action of both sides cannot be protected and rationalized. During the course of economic reform, China needs to establish its legal system according to the rules of a market economy, as in the transition period the lack of legislation on some aspects may influence the development of hotel chains.

4.6.2 Staff redundancy

Some interviewees respond that it is difficult to reform the state-owned enterprises. For example, in Guangzhou, the municipal government has a policy that any profitable firms are not allowed to lay off any staff. Though the staff in the hotel is not competent hotels cannot take any action to optimize its human resources structure. Dongfang Hotel is a public company, but the government is the biggest shareholder, the president and general manager are appointed by the government, the decisions of the hotel are often influenced by government policies, which prevent hotels to take appropriate action to optimize their operation.

4.6.3 Disparity of salary and wage policy

There also exists this problem in some 'well' operated hotel chains. For example, in Gloria, as the hotel management company is registered in Hong Kong, it is treated as a foreign-invested company and the compensation for managers are in line with the policies of foreign companies. However, its vice president was sent by COFCO, a state-owned enterprise, so that the salary of the vice president is much lower than that of other staff of Gloria Hotel Management Company. This kind of paradox and confusion situation is not a favorable incentive for personnel.

4.6.4 Foreign exchange policy

Sometimes policy issues e.g. restrictions on foreign currency may have substantial and unpredictable influence on hotel operation. The GITIC Riverside Hotel joined an online reservation center in Germany and received some bookings. However, the hotel cannot pay commission to the reservation center owing to the regulations and formalities on foreign exchange. In Shanghai the City Hotel was invested in 1984 with a liability of USD 24 million. The exchange rate was US\$1 to RMB 2.8 then, but now the exchange rate has risen to 1:8.3. The policy on foreign exchange almost tripled the hotel loans and put extreme pressure on them.

4.6.5 Price policy

Other policies, like Guangzhou government's ceiling price restriction on hotel rooms in the Guangzhou Trade Fair, also affect hotel business. In Shanghai, the Price Regulation Authority has a price restriction on hostel and inns, which cannot exceed RMB 50 per bed per night. Budget hotels cannot generate any profit according to this price.

4.6.6 Public security regulations

Most regulations for the hotel industry were produced in the old days for guesthouses and are not appropriate for the current situation. For example, the Public Security Bureau in Shanghai allowed only three-star and above hotels to receive foreign travelers. Foreigners are not allowed to stay in a budget hotel e.g. Jinjiang Star, otherwise the hotel will be fined. Many hotel management companies hope that

the regulations that are not in line with a market economy will be removed after China's entry into WTO.

4.6.7 Contradictions among government legislation and regulations

Given the complexity of the administrative system in China, hoteliers complain about the trouble caused by the contradictions and inconsistency of regulatory rules set by different authorities. The major contradictions between legislation and regulations of different government agencies are mentioned below, and it is highly expected that the government should create a better business environment for hotel operation.

For example, in Guangzhou, a hotel license for hotel business includes guest rooms, office tower and shopping center. But when the hotel begins to lease the office tower, the House Authority requires the hotel to register again and charges some management fees on every contract. Some government regulations on pricing are also unreasonable. In Guangzhou, the Price Bureau limited the price of hotels 15 days before the Guangzhou Trade Fair, while the price of hotels was already fixed in the contract with its customers two months before that. The unfamiliarity of government administrative bodies with hotel operation sometimes confuses the hotel industry. Some industry associations can play a role to direct such information to the related government bodies, but it is not very effective. On the contrary, the foreign investor association or the foreign invested enterprises association has a more substantial role in communication. It is expected that the local tourism authorities should play a more important role in coordination on these issues.

4.6.8 Favorable policies for hotel chains

To boost the development of hotel chains in China, in 1993 CNTA in collaboration with the Custom Authority produced some favorable policies for indigenous hotel management companies, which included tariff and tax reduction on imported commodities by hotel management companies. While no indigenous hotel management company could take full advantage of these policies owing to their ignorance and problems of adaptability on these policies. Only three hotel management companies enjoyed the reduction total USD 0.3 billion, and the policy was cancelled in 1995. It is difficult to argue for any favorable policies for hotel management companies anymore.

For hotel development some hotel management companies do not feel any obstacle but expect more encouragement or incentive policies and guidelines. The upper level policy and regulation should be coordinated and consistent to facilitate the operation of hotels. For example there are two sets of standards for hotel grading, one from CNTA and another set from Ministry of Commerce, which may cause some confusion among hotels and guests.

Given the maze of complicated and non-market regulations in China, chain operation and expansion will meet with many problems because some problems cannot be solved by hotel management companies. First, some state-owned hotels are not commercialized. Second, hotel management and operation are not standardized and uniformed in terms of service and quality and vary among different hotels. Third, reform of state-owned hotels should consider the endurance of people and in what degree people can accept the reform plan. Most state-owned hotels have no

insurance and social security for their staff, but rely on the whole reform package of the welfare system in the country. If a hotel was managed by a hotel management company, many redundant employees in the hotel would be laid off, as some of them were very old and not competent to work in the hotel anymore. If a hotel management company was forced to do so, it would cause serious problems, sometimes social instability and political problems. If such reform and policy issues cannot be resolved, it is difficult for hotels to go into a chain operation. The personnel management system, social security and health insurance problems need to be resolved before chain operations are possible.

4.7 *Local protectionism*

4.7.1 Leakage of tourism revenue

The reason for local protectionism in some places is that it is thought the entry of a hotel chain from other regions may cause “leakage” of tourist revenue. It is revealed by a Shanghai hotelier that in some areas in Jiangsu and Zhejiang Provinces, the entry of hotel chains from Shanghai may be restricted as Shanghai is the largest source of tourists to these regions and it is assumed that those visitors would prefer to stay in Shanghai-invested hotels, which caused the drop of profit of local invested hotels.

4.7.2 Restrictions to control overbuilding

In some places there are restrictions on new hotel projects, which is relevant to the whole tourism industry in the region but may cause an obstacle for hotel chains from outside. In a neighbor city of Shanghai - Wuxi, the local government prohibited new

hotel projects as they were oversupplied, resultantly Shanghai Jinjiang Star's expansion was affected.

4.7.3 Relationship with locals

Sometimes when a hotel chain expands to a given place, it is an art to deal with the relationship among various parties in the region as it directly influences the smooth operation of a hotel. To deal with the relationship with the locals, Gloria Hotels assigned a vice general manager, which must be a local, to handle government relations, and various aspects in the society. The Jianguo Hotel Management Company also adopts a policy to use local people, and the local hotel owners will put more effort on it. When the White Swan Hotel expands out of Guangzhou, the company is often put in a dilemma by the local hotels. If the company manages the hotel well and improves it to a certain level, the locals will expel the management company after they become familiar with the management expertise. Later on, when they meet with troubles in operation, they will seek help from the hotel management company again. The locals did not regard the hotel management company as a long-term partner.

4.7.4 Culture conflicts among different regions

Another problem when expanding outside is the cultural conflicts among different regions in China. A hotel management company in Shanghai meets with these problems in other provinces. People may think Shanghai businessmen are too smart and have a tendency to resist them. There are also culture differences in people's concept about consumption and management style. The locals need to adapt to the

hotel management company, and sometimes the hotel management company need to adapt to the local situation. For example, hotel personnel recruitment is commercialized in Shanghai, where hotel management companies recruit in the market or through agents, but when they manage hotels out of Shanghai, they meet with pressure from upper level government to employ their relatives.

4.7.5 Contributions of hotel chains to the local community

Some hoteliers suggest that one way to break local protectionism is that a hotel chain can bring some good or extra values to the local community. For example, the Jinjiang Star's operation improved the local budget hotel standards by example effects on local hotels. Another point is that the hotel can contribute to the local taxation and employment, which gains support from the local government.

4.8 Business culture

It is commented by some hoteliers that from cultural tradition, there is prejudice among Chinese that foreigners have privileges and are more qualified, which causes trouble for Chinese managers from a hotel management company to takeover a position in a hotel. Since the first joint venture hotels emerged in Beijing 17 years ago, Chinese hoteliers have been working and training in MNHCs for many years, but unfortunately they can only act as vice general managers in a hotel, whereas foreigners with just three years working experience can be a general manager.

Some hotel owners do not trust Chinese managers either, which results in the problem for a Chinese hotel management company to negotiate a management

contract. If foreigners have a business model or plan, the hotel owner will easily agree, but if a Chinese manager has the same thing, the owner will always question it.

Another aspect is the obedience among Chinese staff. Even if a Chinese manager was as competent as a foreigner to manage a hotel, he cannot get the high salary that he deserves, as other Chinese employees will not accept it. If foreigners have the same salary, the same group of subordinates will not argue. In China the treatment for a foreign manager and a local manager is very different. Salaries for foreign and local managers are different, which also causes many problems. For example, Chinese managers are not authoritative, but nobody can defy a foreign manager.

The business morality in China is still at a low level and it is difficult to enforce a management contract, for example, the hotel's deferment of the payment of management fee and some extra expenses to the hotel management company. To MNHCs their management contract is very concrete and strict, while domestic companies usually meet with difficulties in contracts.

Another constraint for chain operation is related to Chinese culture as one interviewee said that Chinese are good at individualism but not good at teamwork and cooperation. Complexity in human relationship is also a constraint as in a hotel personal contact among staff can be very complicated.

Another factor is the business practice in China as some hotels would like to lease the hotel to the management company at a certain price but not management contract. This would increase the risk of the hotel management companies that they dare not

take because hotel operations is vulnerable to external environmental changes, which cannot be completely controlled by hotel management companies.

Since the Chinese hotel industry has a long history of management by foreign companies, and high-star hotels are mainly used by foreign tourists, the existing concept may continue in people's mind for a period of time, which also reveals the need for Chinese hotel companies and managers to develop and improve their management level to compete with MNHCs.

4.9 *Organizational Capability*

Some hotel companies feel that the major constraint for growth and expansion was the lack of scientific management, and more emphasis should be put on the building of management competence. For example the Liuhua Hotel thought the reasons that they cannot expand are (1) their capability, short time of operation and lack of experience; (2) awareness in the market and lack of promotion and publicity.

The building of management competence for Chinese hotel management companies is focused in three areas: management model, distribution channel and brand. Most hotel management emphasizes training of staff and recruiting highly qualified employees.

4.9.1 Management model

One argument in the hotel industry is that the Chinese hotel management companies do not have a good management model. However, MNHCs have their own management and service models and can penetrate into the Chinese market quickly.

Bass Hotels & Resorts has different systems for hotel operation, which include assessment system for all personnel, different job description for human resource director, financial director, professional requirement for quality, and various supporting systems. The unified model can ensure the quality of the company and enable the quick expansion. Hotel general managers and financial directors are recruited worldwide. The company searches for them according to specific hotel projects, especially at the opening of new hotels. Bass also changes its sales and marketing strategies according to the market needs. For instance, its logo was “Stay with someone you know” two years ago, but now is “Be yourself”. The product design is not searching for luxury but comfort, and more emphasis on leisure and comfort, ease, the culture of hospitality, and freeness.

Some people criticize that even the biggest hotel company in China, Jinjiang Group has no uniform system, and each manager of a hotel has his own practice. As a hotel management company, it should fix its procedures and produce a model. Though Jinjiang started up a management model earlier, which was assessed and revised every year, some of its hotels cannot match the standards it sets. The reason was the mechanism on human resources and other issues. The quality of management depends more on the general manager, who plays a decisive role in a hotel. However, the economy hotel brand - Jinjiang Star under the Jinjiang Group - undertook

standardization and institutionalization of its product and service as the management realized the importance of chain operation. First, it can ensure the service quality and improve the efficiency; second, it can enhance image in the market.

The Oriental Hotel Management Company adopts a set of hotel management models according to its situation. Previously the company had some scattered standards, references and indications, but each hotel under its management also had its own set of operating manuals. The management modules of all departments were worked out and combined, and a common manual was produced, which will be applied to all hotels. One characteristic of this model is a remote financial control system, which enables headquarters to monitor the expenditure of each hotel via the Internet.

CTS Hotel Company did not have a distinct management model to facilitate, instruct and improve the management of its hotels. The company therefore spent hundreds of thousands of RMB to adopt ISO9000 accreditation to stress its management and monitor hotels in line with the new standards.

Gloria Hotel Management Company has a quite rigorous management system and will work out a management model and norms at the end of year 2000. The company did not simply clone the management models of MNHCs, but combined its own characteristics and adapted to its own situation to produce a system on finance, human resource management and operations. Management rights and ownership rights are separated in all Gloria hotels. The hotel owner sends a vice general manager to the hotel, whether by COFCO or other shareholders. The hotel management company hires most general managers from overseas, and some

Chinese nationals, but do not hire locals as general managers. The vice general manager acts as the representative of owners and monitors the management team, if he finds mistakes on decision making, he can challenge the general manager and make some recommendations. The separation between ownership and management enables both sides to monitor each other. Another separation is that in the headquarters of the hotel management company, the president and vice presidents are recruited overseas, while COFCO sends in a senior vice president and financial director to monitor the operation. Based on the separation of ownership and management, Gloria set up a triangular monitoring mechanism among its general managers, vice general managers and financial directors in all hotels to make sure the appropriate decision-making. All financial directors were sent by the headquarters and authorized to audit all the expenses of GM and vice GMs. The headquarters has a manual of company policy that every manager is required to implement in operation. If any deviation is found, headquarters will ask for modification.

This mechanism creates a good monitoring system in hotels from both inside and outside and ensures the balanced and smooth operation of hotels. On internal management, each job has a description and an operation manual, and all the rules in the hotel are institutionalized, which creates a system to let employees know what to do and how to do. Another characteristic of Gloria is the dynamic human resource management. In every off-season, the hotel company requires each hotel to audit and restructure its departments and personnel according to the performance of the previous year. Some departments or positions may be cancelled or merged. For example, receptionist and cashier at the front office are merged to reduce redundancy and balance work shifts. Assistant manager and guest relations officer are merged to

fulfill a multitask requirement. In Suzhou Gloria, coach drivers and bellboys are merged to escort guests to airport. After the adoption of the dynamic human resources management in Gloria, staff has been reduced from 1.75 per room to 1.5 per room. In case of any manpower shortage, hotels are required to setup a human resources reserve, which includes internship students, part-time workers and job applicants. Hotels also need cross-training programs for employees of different departments, so that when one department is very busy the staff of another department can be dispatched to help. Gloria also emphasizes training to improve the competence of hotel staff. Most of the managers are promoted from within, which is an incentive for staff.

How Jianguo Hotel can expand outside Beijing is also attributed to its management model, based on the idea that one big gap between Chinese hotel management companies and MNHCs is that Chinese hotel companies do not have a big supporting system for their hotels. Even though sometimes the management team sent to a hotel is not very competent and strong, the supporting system can still play a significant role and generate business. A Chinese hotel company, without a good supporting system in marketing and operation, is quite difficult to manage. Sometimes a hotel can succeed in one place, while it is not workable in another owing to the lack of an integrated support system. Jianguo tries to build such a support system for all its hotels that includes a network company, membership program, marketing scheme, and brands.

As a new company, Xingu Hotel Management Company invested a lot on training and learning and produced its management model in 1997. Moreover, the company

adopted the ISO14000 accreditation. The company also invested heavily on its computer network and attracted some hotels for management online.

Shanghai City Hotel worked out a management model in 1996, then some hotels in Shenyang, Jiangsu, and Shandong invited the hotel to manage their property, even a hotel in Britain invested by an overseas Chinese invited the hotel to inspect his hotel. The management company realized that they should expand outside by its model, and not be confined to Shanghai.

For future development, Garden Hotel emphasized management and quality in the hotel itself. The hotel has produced an operation manual and institutionalized the procedures for every department. The hotel also builds its distribution network, which includes traditional and electronic methods to ensure its guest sources.

But some hotel management companies have not formed their own standardized management model. For example, though Huaxia Hotel understands the importance of the model, the company does not want to copy one from other hotel management companies, but would like to build their own management style, procedure and standards through its own practice and experience. Some old hotels have generalized their management experiences and produced the management model and brand, while further improvements are needed.

Generally most of the hotel management companies in China are aware of the importance of the management model in chain formation, though these models vary

a lot. How these models can be further developed to a higher standard is critical for their further expansion.

4.9.2 Distribution system

Some hotel companies find that even though Chinese hotel companies learn the management style from MNHCs and set up their management models, it is still impossible to replace MNHCs in the market. Shanghai Huating Hotel is a good case. The hotel spent more than RMB 10 million for management contract with Sheraton each year. However, the cost for a Chinese hotel management company is much cheaper, so the hotel dismissed Sheraton and joined a local hotel management company. But one trouble the hotel faced was that after it disappeared from Sheraton's worldwide reservation system, the guest flow reduced a lot and the performance was not as satisfactory as before. It is not to say that the Chinese hotel management company cannot manage a hotel, but without the worldwide sales network, the exposure of the hotel in the market is much less than before. The worldwide reservation systems that MNHCs have developed for many years play an important role in hotel management. Bass Hotels & Resorts has sales centers in Beijing, Shanghai, and Hong Kong, targeting giant corporate customers. Hotel chains can take advantage and sign a package of sales contracts with these frequent business travelers, a hotel chain which has more hotels in different places will be convenient for them. Some hotels in Guangzhou joined MNHCs and became more competitive owing to their reservation network. Two cases are Guangzhou Holiday Inn and Guangzhou Ramada, whose hotel bookings and average room rates increased marginally after joining MNHCs. Now some Chinese hotel companies can manage individual hotels fairly well, but they have no profile or awareness in the

international market. Even the largest hotel company in China, Jinjiang, does not have a well- established reservation system, and all the hotels of the management company work solely by their own distribution channel. Some hotels join UTELL or other reservation systems according to their own situation, but the support on sales from the headquarters for these hotels is very limited. To improve the sales system, Jinjiang set up booking offices in Hong Kong and Japan, working as a referral system to introduce guests to each other. The headquarters also requires member hotels to support the establishment of such a network. However, sometimes the member hotels even complain that they do not need such a network. But for the long-term benefit, a hotel management company should establish a reservation network to facilitate the growth of the company. Jinjiang thinks there may be some breakthrough ways to set up a network with the emergence of the Internet but it will take a long time for a hotel company to develop to the scale of MNHCs according to the traditional industrial way of expansion. However, Jinjiang is quite cautious with the computer network because the cost is very high.

Most Chinese hoteliers see that one of the biggest advantages of MNHCs is their distribution channel or reservation system. A major consideration for Xinya to contract its high star hotels to MNHCs is their distribution channels. It needs time for Chinese companies to form their own network. Previously most hotels in China can only use the international computer reservation system (CRS) or global distribution system (GDS). Most Chinese hotel management companies are starting to put more resources on their distribution channel.

Gloria set up reservation centers in Hong Kong and major cities in China. The Oriental Hotel Management Company has a loose referral system among its hotels, but will set up sales centers in several cities in China to form a network by telephone, fax and online reservation. Garden Hotel's distribution channel is mainly through business contacts with agents or corporations; sometimes it sends sale representatives to Europe and America to establish business contacts. The hotel stresses more on online booking and takes it as a direction to follow. The reservation center of Xinya Hotel Group is not very strong, which can only be operated through the traditional way of telephone plus fax. The company plans to develop an online reservation center that can oversee all the bookings within the hotel group.

Most of the MNHCs have support in several technical departments, e.g. reservation center, purchasing, communication, computer, design, and F&B. The CTS Hotel Company aims to build its support system and starts its first step on a reservation center. CTS does not have a center even by the traditional way of reservation, but now the usage of modern electronic technology is planned. Twelve CTS hotels first joined UTELL – an international reservation service provider, to “borrow hens to lay eggs”. The next step will be to establish a domestic reservation network for Chinese customers. It could be a low cost Internet, telephone or fax system specifically for the CTS Hotels, and mainly for domestic use, which can supplement the international network. In the future, the hotel company may have more booking centers, first in Beijing, then in other cities.

Some small hotel management companies also tried to establish reservation centers, as they are aware that why hotels would like to be managed by MNHCs. Huaxia

Hotel has a very small booking center with only three personnel, while they are planning to connect to more hotels and access the major international GDS.

In the low star hotels, managers, who rely more on traditional ways of distribution and personal contacts, don't feel the pressure and urgency to establish a reservation system. Some economy or budget hotels have rudimentary booking services. For example, there is a small reservation network in Jinjiang Star Inns, first through telephone, then inter-hotel introduction, and online reservation. Some low star hotels joined third-party online reservation networks to expand business.

Generally it is difficult and costly for an independent hotel to set up a big network of wide coverage. As an independent hotel, the White Swan pays more attention to sales, marketing and promotion, while it is costly to reach the target sources. The White Swan joined the Leading Hotels of the World, a hotel marketing company with its reservation networks worldwide. The organization can generate about seven to eight thousand room nights to the hotel and more is expected.

Some interviewees are concerned that most of the computer networks and reservation systems targets foreign tourist, which is a small portion of China's tourist market. Most booking centers do not consider the demand of domestic travelers and hotels for their use. It is interesting to find that Chinese travelers seldom book rooms through computer network, but more through travel agency. While more and more people will use the network to make a reservation when they approach the Internet. With the development of the information technology, more and more Chinese hotel companies and hotels are seeking new ways to extend their distribution channels,

which may provide opportunities to narrow the gap between Chinese hotels and MNHCs.

4.9.3 Branding

Previously hotel management companies in China did not have any concept about branding. Now they realize that without a brand name, it is difficult for hotel management companies to expand. Some respondents commented that several years ago brand was not decisive for travelers to choose a hotel, but in an information age, it is more convenient for customers to identify, compare, and choose a hotel by its reputation, brand and performance in the market. Failure of domestic management companies to compete with MNHCs is primarily a problem of branding since branding is the weakness of domestic hotel management companies.

China has some famous independent hotels e.g. Beijing Hotel in Beijing, Jin Lin Hotel in Nanjing, and the White Swan Hotel in Guangzhou, but these hotels are not recognized as nationwide brands. Intec Group proposes to create a good hotel brand in China, and then some hotels in China can congregate under this flag and expand to the target of 100 hotels of the Group. Jinjiang aims to create and develop three brands, then manage hotels by brands. The three brands are high-star luxury brand, commercial hotel brand, and inns or small hotels (motels) named “Jinjiang Star”. Jinjiang established a sub-company especially to develop that brand, while the standards of service, facilities and price are not completed yet. The hotel management companies will tackle the problems of the image of its brands in the market, the quality control of its brand, and the creation of customer pool. The Oriental Hotel Management Company also started its branding strategy in 1999.

However, the plan of whether to include all hotels in one brand or to create 2-3 brands for different hotel stars is not yet determined.

There are also dilemmas in brand usage for hotel management companies. Some hotels would like to use the name of the hotel management company to improve their images in the market. Some hotel companies cannot use their own brand when managing a hotel because the independent hotels would like to use their own brand and object to the use of other names. This is the case CTS Hotel Management Company met with, being rejected by hotels when planning to expand with its brand. Then the company created a diluted "CTS" brand instead of the full name "China Travel Service". CTS hotels plan to create two brands. First, accrediting for four-star and above commercial hotels, which will be experimented at Beijing CTS Tower. Accreditation will be implemented together with branding, creating a new brand and a trademark. Second, based on a hotel in Suzhou City, creating a brand for three-star and below tourist hotels, which mainly cater to tour groups. After accreditation for the two brands, they can build a sharp image in the market and accept evaluation and critique from others. From 2001 the company can expand via these brands within the hotels in CTS system, and even outside CTS in a more acceptable way.

Gloria has created three brands for its hotels - Gloria Resort for five-star, Gloria Plaza for four-star, Gloria Inn for three-star, and perhaps another brand for future two star hotels. Gloria Sanya Resort is the first of this kind of hotel in China.

The Jianguo Hotel Management Company has three brands, namely five-star Jianguo Junhao, four-star Jianguo and three-star Jianguo Business Hotel. Now Jianguo

targets middle and small-scale business hotels in downtown areas and plans to manage 100 hotels in three years. The company plans to develop an economy hotel brand in the future.

White Swan itself is a five-star hotel, after becoming a member of the Leading Hotels of the World, the hotel finds the value of the brand and the changing trend of the hotel industry. Its management company proposed to extend two brands: one as White Swan for five star hotels, another one as Black Swan or Little Swan for three or four-star hotels.

It is interesting to find that some big hotel groups do not even have a hotel brand. For example, Xinya Group owns many hotels but most use foreign brands. The company may consider to build its own brands and first try a possible short cut to joint venture with a foreign company to create brands.

The basic step for branding is uniformity of hotel products and services, though the star-rating system in China has improved the consistency of product quality, it is still difficult for Chinese hotel companies to standardize various hotels. One interviewee compared that MNHCs have very specific requirements for everything, even the awning of hotels, the lobby and hotel rooms. When operating a new hotel, they will recommend their specification and requirements to hotel owners before managing it. It is very difficult for Chinese hotel companies to standardize the exterior and the interior of hotels because Chinese hotels are too individualized, which leads to difficulties in branding. The creation and growth of a brand needs enormous

nurturing and investment. To the fledgling Chinese hotel management companies, this may be a challenge to their resources and business acumen.

4.9.4 Resources

There are resources for Chinese hotel management companies to grow, but they should be evaluated in a realistic way. Whether the hotel management company can attract hotels and manage them effectively, mainly depends upon three factors: First, very competent personnel or human resources, experienced management expertise that enable the hotels to be operated professionally. Second, abundant capital: if the management company can invest in hotels, it can expand in scale. Third, network: if the company can use networks to bring guests to the hotels operated, management can be streamlined. However, the indigenous hotel management companies face challenges in these aspects, as capital is not adequate; deficiency of the existing mechanism cannot attract or even retain human resources; and lack of network becomes a barrier for management.

4.9.4.1 Financing

A disadvantage of Chinese hotel companies is the capability to raise capital. State-owned enterprises have difficulties as most of the old assets are in poor condition, while the company has no rights and freedom to deal with the assets owing to government restriction. This limits the effective utilization of the assets and the possibility to raise new funds. Why most hotel companies in China can only expand through management contract is due mainly to their lack of capital and inability to raise money.

It is revealed that the substantial expansion of some MNHCs in China can be attributed to their capital involvement. For example, Shangri-la changed its strategy of expansion from management contract to capital involvement from its past experience. The ownership enables the company to fulfill its management standards completely. Shangri-la has adequate capital and support from banks, so it can invest according to the market situation. From the very beginning, the hardware will comply with its operation and management requirements. In terms of hardware, software and the relationship between owners, it is better than finding a hotel that is already built and separately owned. Jinjiang expands mainly by exporting management, seldom by capital investment, which makes the management very frail. Jinjiang does not have adequate capital to invest and its expansion by management is influenced by the requirement, situation, and standard of hotel owners when locating and branding.

Hotel companies in China are searching for ways to raise capital for hotel expansion. When Jinjiang built its reputation in Shanghai, the company split off a New Jinjiang Hotel Company to issue stock to raise money and went public. Shanghai New Jinjiang Hotel was the first hotel firm to go public in China since 1993. Until now there are 19 hotel and tourism firms in the Shanghai and Shenzhen stock market, raising funds of more than RMB 3.1 billion. Based on that, the New Jinjiang hotel itself developed as a small new hotel group, acquired some firms and expanded its capability and brand. The newly established Jinjiang Star Inn also used the money raised from the stock market. There are three sources for hotel financing – bank loan, profit retention, and issuing stocks. Generally it is difficult for a hotel to borrow money from banks because the oversupply of hotels makes the return of investment

much longer than before, and banks are not willing to lend to hotel developers anymore. Some good performers can still get money e.g. Jinjiang Star, as they target the right market and return of investment is much shorter than other hotels.

Another hotel company, Xinya Group, also issued stocks to raise capital as well as taking a bank loan. In addition, the company has more joint venture hotels that use money from overseas. At the start-up stage of Xinya Group, most finance came from bank loan. Later the company could expand through profit retention and issuing stocks. To develop its economy hotel brand, the company may use bank loans and increase shares for rapid expansion. For some hotel companies, the capital relies more on profit retention. This is the case of Gloria. Among 10 Gloria hotels, seven are fully invested by COFCO. In the other three hotels, COFCO takes 70% of shares. Gloria also uses some bank loans.

Inadequacy in capital caused trouble for some hotel chains to implement their expansion strategy, and even lead to takeover by some MNHCs. In the CTS Hotel Company, the lack of capital prevents hotels to initiate a branding campaign as just to prepare a nameplate for each hotel will cost hundred thousands of RMB. Uniformity in hotel rooms, lobby, computer systems, etc. also needs a lot of money. It is very difficult for a hotel management company to implement its branding and uniformity strategy without the support from the financial sources. On the other side, this provides great opportunities for foreign hotel management companies to expand. For example, Marriott proposed to grant some loans and took the right of management of CTS hotels. It is very difficult for CTS Hotel Company to borrow money from banks as most hotels are losing money, which puts the company in a

less favorable position to negotiate with banks, and consequently banks rank the credibility of hotels at a low level.

Financing is a challenge to hotel management companies for their growth and expansion. Generally profit retention is slow and inadequate for hotels to expand as most hotels are losing money or have only little profit in China, which caused difficulty to get bank loans. Though in recent years, the opening of the stock market provided opportunities for hotel companies to raise money from the public, it is still difficult to get quota from the relevant authorities and not realistic to push hotels going public.

4.9.4.2 Human resource

Human resource is another barrier to the expansion of Chinese hotel management companies, which includes the lack of professionalism, incompetent and inadequate human resources and constraints from the personnel management system.

The human resource problem for Jinjiang is that the knowledge and skill of the personnel cannot meet the needs of the management model. Many managers of Jinjiang are originally government officials, but not hotel experts. Most of the hotel managers in China's hotel industry are promoted from waiter or waitress without high-level professional training. Many general managers and department managers have never experienced higher education, which results in the lack of professionalism.

Most hotel companies find that it is difficult to recruit competent managers, especially general managers and sales managers, but relatively easy to recruit middle-level managers. Some hotels identify the competence requirements of hotel managers in China as professional, foreign language skill, and good at human relationship. Huaxia Hotel Company manages three hotels and gets a new contract from a hotel in Shanghai. However, the company cannot recruit adequate competent personnel to operate the new hotel and finally quit that contract. Some Chinese hotel companies e.g. Gloria hire foreign managers in the world market to keep a unique image in the market. Some people argue that there are problems for foreign managers. First, the cost is high; second, foreign managers are not familiar with China and may meet with difficulties in communication in both language and culture; and third, it is time consuming for foreign managers to get ready for work in a Chinese hotel.

It is interesting to note that one hotel company, the White Swan, uses all the managers from within, and does not recruit from the outside. The reason is that the White Swan thinks the company has its own characteristics in hotel operation; most managers are trained, and promoted from within. The company would not like to use personnel who have worked in other hotels, as the past experience may ruin the brand and fame of the White Swan. However, with the development of more hotels, the hotel will think about recruitment from outside to counteract the limitation and scarcity of internal staff.

Worrying about the lack of competent human resource, CTS Hotel Company proposed that CNTA should set up a human resources database in the hotel industry

to help hotels, as many hotel companies search for human resources through headhunters, but are not confident of the personnel recruited.

Another problem is the actual human resources management in hotel management companies. Most MNHCs have not many people in the headquarters, when getting a new project they will recruit managers from the market. This is impossible for Chinese management companies as the employment is not completely on contract. A hotel company may manage five hotels in one year and then decrease to three the next year, but the management company cannot fire these redundant managers from the extra two hotels and need to provide other job opportunities for them in the company, resulting high cost and low efficiency of the company. The problem of human resources is attributed to the current ownership and mechanism because in some state-owned enterprises, recruitment, promotion, and incentives of managers do not coincide with their performance. Xinya Group has a more commercialized mechanism than some other companies when recruiting essential human resources, because it is a stock company and has more joint venture hotels, providing more flexibility than state-owned hotels.

One important reason given by a hotel company about human resource management is the defect of the training system and programs for the Chinese hotel companies. Most domestic companies lack good, high-level training programs for staff. Some MNHCs also have a localization policy for human resources in China. It is interesting to note that some hotels are quite anxious about the difference between the MNHCs and indigenous hotel companies, and expect the Chinese hotel managers of the younger generation to reach a higher standard.

4.10 Assessment of availability in joining chain operation

4.10.1 Knowledge of chain operation in the hotel industry

Most hotel companies and hotels interviewed are aware of the comparative advantages and disadvantages between chain operation and independents, while some hotels are not quite aware of the concept and practices of chain operation in the hotel industry, especially low star-rated hotels. Some hotels did not even know about chain operation.

Some companies are quite clear about the advantages of chain operation. For example, Jinjiang Star has a bulk purchase scheme and an inter-hotel personnel exchange program. Those hotels can identify and take advantage of hotel chain affiliation advantages, such as human resources, financial resources and other resources exchanges or sharing among hotels, shared advertising campaigns, professionalism, maintenance, marketing, referral of guests, image development, service and management model, purchasing, decoration and standardized operations.

Some hotel chains e.g. Gloria, can enjoy both the advantages of economy of scale and economy of scope. More hotels in the chain can disperse the risk of hotels. Gloria also diversifies its hotel operation to hotel related business of hotel supply, through its strategic alliance with Coca Cola, Great Wall Brewery and other COFCO partners to provide commodities for the whole chain and other hotels.

The obvious advantages for an independent hotel managed by a chain, especially MNHCs, are financial resources, brand and guest sources. Take the Guangzhou China Hotel for example, before being managed by Marriott, its overseas bookings

were about 400 rooms per month; Marriott affiliation increased such bookings to more than 1000 per month. In hotel sales and marketing, independent hotels are very different from chain hotels in terms of budget, advertisement, reservation center, network, global positioning, publicity and operation. However, to the independent White Swan Hotel, it is very difficult for the hotel to market overseas as the expenses on publicity and advertisement are quite high. The hotel set up a representative office in the US, but high costs incurred, which maybe the biggest obstacle for independent hotels to expand their sales. The role of chain operation is also obvious in the sales of tour group. If a tour group travels around several cities in China, the travel agency can book a package of hotels with a chain, e.g. Sheraton, Hilton or Shangri-la at a favorable price. However, if the travel agency uses independent hotels, it needs to book different hotels at various places, which is inconvenient and cost-ineffective.

The most obvious advantages that Chinese hoteliers feel about chain operation are the distribution channel and reservation systems, especially those of MNHCs. For example, since Shanghai Huating Hotel terminated its management contract with Sheraton, its market share dropped in some markets as a large portion of its guests were coming from Europe and America through the Sheraton reservation system.

However, some hoteliers argue whether the advantages of chain operation could be so obvious. Take the Kempinski Hotel Beijing for example, Kempinski is a hotel chain with 100 years of history, headquartered in Germany. When expanding outside, the company did not have a very strong network owing to the lack of adequate human resources. Kempinski has three hotels in Asia and only one in China. Its

reservation network generates only 5% of business to the hotel in Beijing. In fact, that hotel is quite “independently” operated and does not rely on the distribution channel of the chain, while it can still do very good business. The interviewee stressed the importance of targeting the right market, but not heavy reliance on how big a chain is.

Some hoteliers also identified the advantages of independent hotels, such as quick reaction to the changes in the market, while a chain hotel depends more on policies from the upper-level, which may bring about management inertia and tardiness. As an interviewee describes that “if they are not sensitive to the changes of the market, it will be dangerous to them. For us, independent business travelers and group tourists changed a lot in a short week. I required the sales department to segment the market and choose guests according to our market target. It is easier to do that in an independent hotel. But in a chain hotel, it takes a long time to prepare”. Such decision-making is quick in an independent operation, and the hotel can provide more opportunities and promotions for its staff. Independently operated hotels can look at things from a long-term view, while a management company may have more speculative interest in the hotel. One problem for chain management is the high turnover of managers. Managers serve for a very short time and their knowledge and experience and management style vary a lot; the subordinates in the hotel do not know what to expect. For example, in a hotel once managed by a Hong Kong-based hotel company, the sales manager had been changed six times in five years, which brought about confusion to the hotel. Another problem is that some hotel management companies make money from commissions in the purchasing process. In one hotel, every time the management company changed its F&B managers, they

would change the restaurant appliances and buy new products. The management companies can get commission, while this is a waste of the hotel resources. In China, there are particular advantages for some independent hotels. For example, some hotels are designated to receive conferences of government agencies and related institutions. This is a special case in the planned economy.

Another argument between independent and chain operations was the role of general managers. It may be difficult for chain hotel managers to adjust its management practices. Once the hotel management company has produced the policy, the general manager (GM) will obey and implement but has no rights to revise it. General managers in chain hotels do more on implementation, once the policy and market changed, they may not adapt to it. Independent hotel managers have more power in management and can respond quickly to the market, guests and staff. The disadvantage for independent operations is that the management is not as systematic as that of chain operation. Independent hotels can take advantage of adaptability and personality to improve their management.

Chain operation can also help to improve the entire management level of the hotel industry through uniformity and standardization. As one hotel management company suggests, if the hotel management companies in the developed area in China expand to the less-developed areas, the whole industry will be upgraded because there is still gap among hotels in different areas in China.

In summary, the advantages of chain operation are seen to be:

- Economy of scale and economy of scope;

- Bulk purchase program;
- Sharing and exchange of human, financial, and other resources;
- Distribution channel and reservation systems;
- Marketing (budget, campaign, advertisement, brand, image, tour groups sales);
- Professionalism in operation, maintenance, decoration and technical support.

The advantages for independent operations are reported as:

- Quick reaction to market changes;
- More flexible in operation and decision-making;
- A long-term view of its own operation;
- Care more about its staff;
- Stability and less turnover in the management team;
- Specialization in some specific market niches.

4.10.2 Types of hotel chain formation in China

Given the complexity of ownership, administrative system and regional differences in China, the formation of a hotel chain or group varies greatly. From the interview results, basically three types of hotel chain formation can be identified as: traditional hotel companies; government or organizational conglomeration; and, hotel-based growth.

4.10.2.1 Traditional hotel companies

Traditional hotel companies started early in the hotel business and constructed many hotels along with the development of the travel industry in China. Hotel chains and

groups were experimented with in 1984 as the hotel industry in Shanghai started and was “commercialized” earlier than the rest of China. Five hotel groups, namely Jinjiang, Donghu, Huating, Xinya, and Hengshan were registered by the government to optimize the hotel assets belonging to different government agencies in Shanghai. As an example, Xinya was a company created by the Commerce Commission, which primarily operated some low-class hotels. The company took the good opportunities of tourism boom during the 1980’s and built some new hotels and renovated the old hotels through joint venture with foreign investors, taking advantages of favorable policies on the reform of group enterprises. The hotel company grew to a hotel group, and began to issue stocks to raise capital for further investment in 1993. In 1996 the hotel group went public and grew to a large-scale hotel company with 22 hotels.

4.10.2.2 Government or other organizations’ conglomeration

As most hotels were controlled by various government agencies, state-owned companies, and other relevant organizations in China, many hotel assets were split out from these organizations in line with the reform and the requirements of assets restructuring. The Beijing Municipal Government transferred all its hotel assets to the Beijing Tourism Group to create two hotel brands - Jianguo International and Peace Holiday. The Jianguo International Hotel Management Company manages several hotels in Beijing, Datong, Kunming and Xi’an and is projected to expand throughout China.

China Travel Service (CTS) was one of the largest travel companies in China, with almost 120 hotels across the country, which were mainly for political reception for overseas Chinese in early years. Since the opening-up and reform in 1978, these

hotels were “commercialized” and transferred to the local CTS branches and the Overseas Chinese Affairs Offices. Most of these hotels now face problems of heavy debt burden, drop of profit and loss of money. Though these hotels all are in the CTS system, they vary in ownership, have different names (such as Overseas Chinese Hotels, Overseas Chinese Mansion, Overseas Chinese Building), and have no uniform sign or logo. CTS decided to establish a hotel company to operate all its hotels and improve their performance step by step.

In 1997 the Bank of China conglomerated all its hotels from both the bank headquarters and regional branches and transferred the assets to its sub-company - the Oriental Investment and Trust Corporation, then established the Oriental Hotel Management Company to manage all these hotels.

Gloria International Hotel Management Company is a hotel company invested in 1992 by one of the largest trade companies – Cereal, Oil, Food Import & Export Corporation (COFCO) through one of its Hong Kong subsidiary companies Pengli Group. Starting from the first hotel in Beijing, the company soon expanded to the northern China cities of Shenyang, Dalian and Harbin, then to south China’s Qingdao, Suzhou and Sanya. By 1999 the hotel company had conglomerated 10 hotels and was ranked as no. 219 in the world three hundred largest chains (Hotels, 2000).

Xingu Hotel Management Company is a new company in the Caohejing Hi-tech Development Zone in Shanghai. In 1994 the Zone transferred the management right of all its real estate properties to the management company. This was part of the

assets split and diversification strategy of the hi-tech zone, which will provide new opportunities for the growth of the hotel industry there.

Dongfang Hotel Group will be transferred to another company, Yuexiu Group by the Guangzhou Municipal Government. After restructuring, Yuexiu Group will combine their existing hotels with Dongfang and other travel related companies to form a new conglomerate company for hotel and tourism business.

However, conglomeration by government authorities or similar organizations is questioned by some hoteliers, as usually such contrived hotel groups will not succeed. A criticism of the Beijing Tourist Group is that the creation of some new brands by the group may ruin the business of the previous firms. The Group conglomerated 108 enterprises with a total of RMB 10.7 billion assets belonging to the Beijing Government, which covered hotels, tour operators, transportation, real estate, and advertisement. Guangdong province has also practiced conglomeration in the tourism industry. However, another argument emerged is that the major consideration to form these conglomerates was to relocate government officials to the enterprises during the course of government restructuring, but not for the development of the tourism group.

4.10.2.3 Hotel-based growth

Some hotel management companies started up from a single name brand hotel, which was used as a base to export management to other hotels, and then to form a chain if possible. This is the case of several five star hotels in China, e.g. the White Swan Hotel, Garden Hotel and Dongfang Hotel in Guangzhou, Jinlin Hotel in

Nanjing and some others. After many years of operation these hotels created their images and favorable positions in the market. With the accumulated management skills, experience, and resources, these hotels can export their management expertise to the hotels in other cities and provinces. Their own hotel can be used as a good base for other hotels to learn from, and when managing new hotels, the existing hotel can be good backup for the new hotels (e.g. as a training site).

4.10.3 Considerations of hotel companies and independent hotels

For hotel management companies, the assessment of hotels to be managed includes location, scale, and market situation. Whether to join a hotel chain or keep independent is a decision by hotel owners who will think about the cost-effectiveness of chain operation. Some hotel owners think that hotel management companies take their management fee and high salary while without any obligation and risk in the hotel. Though hotel owners understand the advantages of hotel management companies as providing more reliable guest sources and support in operation, after comparing gain and loss, they choose self-management rather than hotel management company. Generally the requirements from the independent hotels become more and more demanding as hotels need stable profit, which made the hotel management company contract difficult to negotiate.

The most important consideration for hotel owners in choosing a chain is how many benefits it can bring about and how much the management can be improved. If considering joining a hotel management company, firstly the independent hotel will assess the brand of a hotel management company, as brand itself is an intangible

asset, which also represents the capability in sales and management. Another important factor is whether the hotel management company will tightly control the hotel and be ungenerous in technology transfer. A hotel management company can make money through management as they can bring in management expertise, if the company does not desire to transfer technology and management expertise to the hotel, it may not be chosen by independent hotels. When choosing a company, the hotel will take a serious attitude and consider many factors: how much profit a hotel management company can generate and how much the management fee will be. If the balance between the management fee and the profit increase were not lucrative, the hotel would like to keep independent. To some hotel developers, when selecting hotel management companies, they have more considerations: whether the management company can generate more business and make more money; whether the value of the real-estate of the hotel will increase; whether the management company can improve the salary and expertise of the hotel personnel.

To some MNHCs, the main reasons why Chinese hotels join are the consciousness of brand and their sales network, which can ensure the quality of a hotel and the source of guests. For example, Holiday Inn can generate 12-13% of guests through its network to hotels in China and almost 20% to hotels in Beijing. Some walk-in guests are also attracted by the brand. However, the costs of management by Holiday Inn could be as high as 2.5% of revenue for basic management fee and 6-8% of profit for incentive management fee.

To sum up, considerations for some independent hotels to join a hotel chain mainly include:

- (1) Benefits brought to the hotel by chain;
- (2) Awareness and compatibility of brand;
- (3) Management fee;
- (4) Management style;
- (5) Source market;
- (6) Performance of the existing hotels managed;
- (7) Recognition by the existing hotels;
- (8) Professional and human resource;
- (9) Real estate value;
- (10) Technology transfer;
- (11) Other requirements.

The reasons why some independent hotels dismiss hotel management companies are mainly the management costs and the development of the hotels own management competence. The costs incurred mainly include the management fee, which could be more than RMB 10 million a year, and the salaries for expatriate managers, which could be as more as the total of thousand local employees'. Furthermore, some of the managers sent in by hotel management companies are not qualified and competent. Over time if the managers of the hotel become competent, the hotel can go independent from the hotel management company. Consequently the sales network of the independent hotel may be influenced as the hotel management company controls the distribution channel, which is a challenge for independent hotel to rebuild the network.

A hotel once joined a Singapore hotel management company and paid 5% of GOP and a percentage of surpassed profit as reward to the company. After assessing the performance of the management company and finding that the advantages in the guest sources were not obvious, mainly depending on personal contacts of general managers, the hotel decided not to continue the contract with the manage company. The main reasons to stop the contract were the high cost, and the high salary of foreign employees.

4.11 Forms of chain formation

Typically the forms of chain formation can be categorized as asset involvement or non-asset involvement. A hotel company can invest in a hotel then manage it, or just manage with its “software”, which will have different effects on management and shape how the hotel management company will proceed.

Generally the types of chain formation include direct investment, merger/acquisition, management contract, franchising, consortia and referral systems. Direct investment and merger/acquisition involve hotel assets, while other forms seldom require assets involvement. It is found that in China the most frequently used form of chain formation is management contract, then direct investment. Franchising is seldom used. There are cases of consortia and referral systems, but they are not very successful. Given the special characteristics, some hotel management companies can only offer consultancy and training services to independent hotels, which forms a very preliminary stage of chain operation. Some hotel management companies use a mixture of these ways. For example, The Jinjiang Group expands outside of Shanghai and exports its management by management contract, consultancy, pre-

opening management and partial management (e.g. F&B). While the Jinjiang Star brand uses direct investment, leasing, franchising, but no management contract.

4.11.1 Direct investment

Most hoteliers regard direct investment as the most effective way of chain formation because the hotel management company can have full control of these hotels. For some existing hotels it is difficult to form a chain through asset involvement as hotels are capital intensive and have different ownership types. A widely accepted view in the hotel industry is that to manage a hotel in China, it would be better to have some capital or asset involvement; otherwise hotel owners will dismiss the hotel management company easily. Capital involvement can make the hotel owner feel that the management is more reliable and can bring substantial benefits to the hotel. More importantly, the hotel management company becomes a shareholder through capital involvement, which enables the company to have its own voice on the board. A good case is Shangri-la, which invests, builds and manages hotels by itself. More companies are expected to manage hotels through capital involvement, as most people think that management without capital involvement is not reliable.

Xinya invested in most hotels to form a group and benefited from the technology transfer from MNHCs. The first way of investment is to set up joint venture hotels with overseas investors, which brings about not only capital, but also international practice and management concepts to the company. Xinya also contracted most of its solely invested hotels to MNHCs for management, which include the New World, Accor, Holiday Inn and Inter-continental in order to improve its management

expertise by learning from these MNHCs with advantages on guest sources, network, operation manuals, etc.

The reasons why some hotel companies do not use direct investment are that: a hotel is capital intensive and needs huge financing for hotel projects; expansion is too slow as construction of hotels takes a long time; labor cost in China is cheap, but the construction cost of hotels is high, as the land price is not cheap plus the expense of machinery and equipment imported from overseas.

The overprovision of hotels and the structural change also made new investment in hotels unprofitable. One reason why some hotels need a management company is their blindness in the investment in the hotel sector without comprehensive feasibility study on the market. After the hotel was completed it was found to be not successful in business so that the owners turn to hotel management companies for improvement.

However, it seems that some MNHCs changed their strategies of expansion in China from management contract to more capital involvement. For example, Sheraton invested in several hotels in China. Bass is also exploring capital involvement and seeking investment opportunities in gateway cities for some of its brands. Formerly its policy was to manage hotels without capital involvement as the company concerns the risk of investment, but now it is ready to invest. In addition, some creative ways of assets involvement were tried. For example, Accor exchanged some assets of a hotel in Paris with the Beijing Tourism Group.

There are companies investing in many hotels, but those hotels cannot form a chain because of the lack of strategy and professionalism in the company. Guangdong International Trust and Investment Company (GITIC) invested in two hotels in Guangzhou and others in Shenzhen, Zhuhai, Dalian, Taishan and other places. Every hotel in these places is regarded as successful, but each is a discrete entity. Later GITIC planned to set up a hotel management company to operate all these hotels systematically and professionally and worked out standards, uniformity and brand scheme, which could take advantage of bulk purchase, finance, human resource and marketing of a group. However, GITIC went bankrupt later and the hotel company could not be created.

4.11.2 Merger and acquisition

Generally merger and acquisition in the hotel industry is seldom used as a way for the growth and expansion of hotel chains owing to the particular economic mechanism in China. In a complete market environment, if a hotel has a heavy financial burden and cannot afford it, it should go bankrupt. But bankruptcy never happened in China, as it concerns political stability and social security systems. Most hotels belong to government agencies, and they will lobby banks or the central government to get subsidy to repay for this hotel. In such a mechanism, merger/acquisition rarely happens. Some industry people predict that merger/acquisition will happen soon as the economic reform in China proceeds. With the reform of state-owned enterprises, more and more solely state-owned enterprises will be transformed to real commercial firms in the market. In China the exchange of property rights includes takeover, reform from sole state-ownership to

the limited liability companies, or going public through issuing stocks, which offers opportunity for assets restructuring in the hotel industry.

Now most merger / acquisitions in the hotel industry are conducted by the government. In fact these should not be considered as merger/acquisitions, but the transfer of assets among different agencies. Shanghai government merged a big company, Huating Group, with Jinjiang Group, aiming to take the advantages of both companies and grow Jinjiang into a more powerful company. Beijing government also merged all its assets in the tourism industry to form a conglomerate tourism group.

On the other hand, some hoteliers expected the merger/acquisition by government and considered it as a way for hotels to grow. For example, City Hotel in Shanghai expects its upper level administrative agency, Shanghai Youth League, to combine all its enterprises (Shanghai China Youth Travel Service, Shanghai Youth News, Youth Management Institute, Youth Technology Development Co., Great World Entertainment Center) together and restructure these assets for further development.

Some big hotel companies with adequate capital are considering expansion through takeover. Dongfang hotel group is doing some feasibility study to purchase two or three hotels to expand at a low cost. After the Asian Financial Crisis, hotel investment and provision in China offered good opportunity for hotel chain formation and expansion. Since 1998 some MNHCs and investment banks have been actively involved in takeover of hotel assets or management in China.

4.11.3 Management contracts

Management contract is the most commonly used form of hotel chain formation in China by all the hotel management companies. However different hotel management companies have different practices.

CTS Hotel Company realized the importance of benefits brought by the management company to the hotel, emphasizing more on building of its advantages on bulk purchasing, cost reduction, reservation system, brand, etc. The company changed its way of expansion, but didn't accept hotels indiscriminately.

Gloria changed its expansion strategy from direct investment to management contract since 1998. The major consideration is that the return of investment takes a longer time. In the 1980s return of investment took 5-10 years for a hotel, in the early 1990s it took 10-15 years, but in the late 1990s it took over 15 years. Since 1998 the hotel industry as a whole was losing money, with hotel supply exceeding demand, which put more pressure on the existing hotels for profit. Since 1998 Gloria has considered that it is not necessary to build new hotels but started to build its management model and planned to attract more hotels by contracts, first aiming at the hotels invested by regional COFCO branches, then probably hotels that do not belong to the COFCO system.

As a hotel group, Xinya contracts most of its high star hotels to MNHCs, but sets up a hotel management company to operate the three-star and below hotels of its own. Through this way, Xinya can learn from MNHCs and build its own management model through technology transfer in the hotel company, then manage other hotels

that it is capable of. When managing hotels out of Shanghai, Xinya has a small portion of capital investment in some hotels then manages them by contract. Another kind is management contract without capital involvement by its management model, this form will be encouraged and used more for future expansion as it requires less or no capital and can build a network much quicker.

The management contract of Jianguo hotel is quite flexible. The headquarters mainly uses its brand to manage hotels according to their own situation. Every hotel reports its marketing, finance, and competition situation to the headquarters, which will produce policies and give instructions to each hotel. Jianguo mainly depends on management contract and only has capital involvement in some hotels. When negotiating the terms of management contract, some hotels may have unacceptable terms for the management company, for example, assurance of a certain profit, otherwise, subtracting from the management fee, which is too risky for the management company.

Some independent hotels feel that management contract is the simplest way to form a chain, while it will meet with obstacles, especially in the state-owned hotels. The precondition for management contract is that the current management team of the hotel has to give up its rights. However, in the state-owned hotels the biggest obstacle is to give up the management right. A good case is that the Xijiao Hotel would like to be contracted to the Oriental Hotel Management Company to improve the management and performance of the hotel, but when Oriental sent in its directors, the existing hotel managers all objected because they would lose power, and possibly

needed to find new jobs. At last the hotel compromised and only invited the Oriental Hotel Company to provide some consultancy and training services.

The duration of management contract between domestic hotel companies and independent hotels is usually as short as 2-3 years, while with MNHCs it can be as long as 8-10 years. It is impossible for a hotel company to make money in three years because when the effect of management emerges the contract is due. Why hotels sign a long-term contract with MNHCs may be due to some culture or attitude inclination, as some Chinese hotel owners take for granted that foreigners are more competent than domestic managers. Generally MNHCs have more bargaining power and a stronger position for their policies. Another problem is that the contract between the Chinese hotel management company and the independent hotel needs to be negotiated every year. Independent hotels have more bargaining power in the market and can terminate a contract any time if they are not satisfied.

4.11.4 Franchising

Franchising is seldom used as a way of chain expansion in China owing to its special requirements, which relates to the whole economy development level, enterprises management level, legal system and education standard in the country. Even some MNHCs have not started yet because they question the feasibility of franchising in China owing to its lack of relevant legislation, which may cause trouble later. But recently franchising has been tried by some companies e.g. Jinjiang Star. Hotel owners have their own land, capital and hotels; Jinjiang Star Inn franchises its brand, standard and management model to those hotels and charges franchise fees. Some hotel companies are also interested in franchising, for example, CTS will try a

franchising operation for its accredited brands. The company considers franchising as a faster and better expansion mechanism than management contract as franchising is based on brand, not equity. Hotels of different ownership types can congregate under the same flag and concentrate their sales for common benefits, which may be more available in the circumstance in China.

4.11.5 Hotel consortia.

Some hotel consortia have emerged in China. For example, Dongfang Hotel in Guangzhou initiated a VIP Hotels Club, which has 40 member hotels nationwide. The reservation center of this club issued 220,000 membership cards at a price of RMB 400 each to promote hotels.

Some international hotel consortia have also expanded in China, e.g. The Leading Hotels of the World. Kempinski Hotel Beijing joined the consortia and brought in about 3% of guests from the organization. Compared with the Chinese consortia, the membership fee and commission for reservation of the international consortia is much higher. Dongfang Hotel has joined UTELL, though the hotel can enjoy the benefit of using the system of the consortia to target the market, the effectiveness is not obvious compared with the high commission.

The argument in the hotel industry is the effectiveness of this form of alliance. Some hotels tried and are trying consortia or referral systems, however, it cannot play the role of a chain but as a joint force on sales and marketing. Jinjiang Group has formed this kind of organization among its hotels to introduce guests with each other at a special price, but generally the volume of the guests generated by the network is not

significant. The roles of this kind of organization are not as obvious as the network of hotel management companies and it is impossible for a hotel to rely on this kind of organization to bring in too many guests. However, it is recommended by some hoteliers to form more consortia according to the special administrative framework in China. For example, hotels belonging to the aviation industry, post and telecom industry, customs and so on can try this form in their own system and use this kind of alliance to enhance their marketing and sales in the market.

4.11.6 Referral system

Some hotels join the international referral systems or marketing organizations. For example, Garden Hotel joined Summit Hotel International. However most hotels feel it is not very effective and cannot generate many guests. Some hotels also tried to set up similar organizations. There emerged some hotel reservation organizations in China, which acted as referral system. One prominent organization is the Intec Group. The Group has a reservation center of 50 desks and provides services by toll free telephone, fax and computer 24 hours a day, 7 days a week. The toll free reservation service covers 258 cities across China. Intec Group issues credit cards and hotel discount cards to customers with the major banks in China and tries to attract cardholder to use the designated hotels as millions of cards have been issued and the cardholders can enjoy preferential services. Based on that the company has set up a tourism e-commerce network and promote it in the public. Notably there have emerged many online reservation companies recent years in China to offer booking services for hotels, which may be regarded as a new form or new trend of referral in the hotel industry.

4.11.7 Consultancy

Due to the difficulty of investment and management, some hotel management companies cannot get involved in substantial operational management, or try to avoid embarrassing relationships with the independent hotel, they choose to offer management consultancy services to some independent hotels, which include pre-opening training, and so on. As it is witnessed that without capital involvement hotel owner can drive the management company out or suspend the contract any time, hotel management companies dare not risk the embarrassment of management contract, and changed to offering consultancy and training service for hotels.

4.12 Management / operation issues

After recruiting a hotel to the chain, relationship with hotel owners is quite a critical challenge to hotel management companies, and many problems may arise.

4.12.1 Hotel owner's intervention

Hotel owners' intervention in operation and management is a headache for many hotel management companies. The White Swan contracted a hotel in Dongguan City, after a year's operation the hotel business was marginally improved, then the owner began to intervene and the hotel management company had to withdraw.

For some hotel management companies, e.g. Jinjiang Star, relationship with hotel owners is quite explicit. Hotel owners are not allowed to intervene in the operation and management of the management company, and the management company has the most power of decision-making. In Gloria, relationship with the hotel owner is quite easy as COFCO held most shares of the hotel. If other owners are not satisfied

with the management company, the company may change the general manager and try to improve the performance. In China, capital involvement is necessary for hotel management companies as once there is dispute, other hotel owners cannot fire the management party easily. Most hotel management companies suggest capital involvement in a hotel rather than just managing it.

4.12.2 Dispute on contract

A major concern is the delay in payment of management fee. The management fee has dropped to a quite low level, previously 3% of GOP, but now only 2.5-2.3%. Hotels often postpone paying the management fee even though there is a management contract. If a hotel is very profitable, the conflict between hotel and the management company will be diluted, otherwise the conflict will be intensified.

Another issue is the dispute over operating benefits or losses, which will relate to the responsibility and the allotment of benefits for each party. In addition, once the leader of the hotel is changed, everything has to be changed, possibly even termination of the previous contract.

Another interesting finding is that MNHC contracts usually last a long time, while indigenous hotel company can only get a short duration. For example, duration of the contracts of Bass Hotels & Resorts is at least 10 years, some 20 years, while the duration of indigenous hotel company contract is only one to three years. The first three years can only lay a foundation for management then the stable revenue can be generated.

There are also differences between the clauses of management contract of MNHCs and indigenous hotel companies. The management contract of Bass is quite rigorous and hotel owners will abide through contract negotiation. The contract of the indigenous hotel management companies is much looser, once there is dispute, there will be more problems. It is better to make things clear in advance. The contract of Bass basically is a worldwide format, aiming to ensure the normal operation of the hotel management company, but may change according to the demand of hotel owners. After signing the contract, Bass sends a general manager to run the hotel and provides a set of personnel and operating manuals, daily operation standards, interior periodic quality inspection, and open or secret assessment. The board of directors of the owner controls budget and other important issues, some hotels require that every cheque must be signed by both the management and hotel owner, otherwise nobody can take out the money.

But in some less developed areas in China, contracts cannot be enforced as hotel owners still act as what they like though there is a management contract. Contract cannot fully protect hotel management companies in China. Some hoteliers think the only thing that can really protect the hotel company is the talent and professionalism, network or investing in a hotel, and the art of the general manager to handle the relationship with hotel owners.

The troubled relationship between hotel management companies and hotel owners may be attributed to the state ownership system, as Chinese hotel owners are different from those in a market economy system. Chinese hotel owners are delegated to be the supervisor of the hotel assets and have the rights of owners, for

example, choosing managers, monitoring managers, and investment issues, but those owners do not enjoy the income as hotel owners, which brings about the biggest problem of Chinese hotel owners - they do not care too much about the profit of hotels, as this does not relate to their income. State-ownership may also cause another problem of government intervention because the upper-level government agencies often harass the hotel management for various kinds of benefits.

4.12.3 Communication between hotel owner and management team

Management companies need to communicate with hotel owners on some important issues such as maintenance and use of capital. Given the particular business culture in China, general managers who only pay attention to operation and management, but less on relationship, will fail. The hotel management company needs to keep good relationship with hotel owner through personal contact and benefits.

4.12.4 Other issues

Another interesting aspect of the relationship between management company and hotel owner is that at the early stage both sides are usually quite satisfied with each other, but after operation and management for a period of time, the staff is trained and the departments are set up, hotel owners begin to criticize as they feel the management company is not needed anymore and would not like to pay the management fee. In addition, the regional imbalance on salaries may also influence the relationship between two sides as the managers sent by the management company generally have higher salary. For example, the managers from the hotel management company in Guangdong costs RMB 7-8,000 per month, while hotel

managers in Sichuan Province are paid only RMB 2-3,000. The disparity on income many cause tension among employees.

4.13 Competition with MNHCs

Generally the entry of MNHCs into China is beneficial to the hotel industry as it could improve the service quality and management level of Chinese hotels. Hotels operated by MNHCs are more profitable and had better performance than local companies.

4.13.1 Comparative advantages of MNHCs

The major advantages of MNHCs are long history, good performance, name brands, and high profile in the market. For example Bass Hotels & Resorts has brands of Inter-continental, Crown Plaza, Holiday Inn and Starwood has Sheraton, Westin, Four Points, St. Regis, the Luxury Collection, and W Hotels, which can provide a variety of products in the market.

Jianguo feels that the biggest difference between domestic companies and MNHCs is the supporting system, e.g. sales and marketing campaign. Starwood has its SPG Program (Starwood Preferred Guest), which spent US\$ 16 million on worldwide promotion in 1998, which cannot be copied by Chinese hotel management companies.

After China Hotel Guangzhou was managed by Marriott, it could use the overseas distribution system of Marriott, which could play a significant role in competition,

especially in the overseas market. Currently the White Swan Hotel, another hotel positioned in a similar market, has the largest market share in Europe and America, while China Hotel may take more market share depending on its global distribution system.

Another advantage of MNHCs is their systematic approach, especially on finance and budget. For example, when the Peninsula Group managed the Garden Hotel in Guangzhou, the company made out the budget plan every September for the next year. Once approved by the board, the expenses were strictly administered in line with the plan. In addition there was a contingency plan of about RMB 1 million for some urgent usage. Any extra expenditure needed to be approved by the board. In contrast domestic enterprises are quite haphazard in finance and too flexible in budget control.

Another reason why hotels choose MNHCs is that they are more professional, while some Chinese hotel management companies do not have enough professional training. An interesting finding about why independent hotel joins MNHCs is that the hotel cannot break away from the trouble of government intervention so to choose a foreign management company to speak for them.

The disadvantages of domestic hotel companies are: the confusion of the ownership system, the related decision making mechanism, and the relationship among employees. Domestic hotels cannot resist interference from government agencies, and the problem of human relationship almost does not exist among MNHCs as they have their standards of employment.

For some MNHCs it is relatively easier to expand business. Starwood entered China early and enjoyed the large-scale presence in China with more than ten hotels and the ready established distribution/reservation network. The company has more localization policies than some newcomers. The headquarters is responsible for business plan, mainly consisting of finance, sales and marketing for all hotels. The headquarters runs a reservation system, which is the most important support for all the regional offices and hotels. The administrative framework of Starwood gives more rights to the regional offices, with all the business development projects negotiated by regional offices for expansion. The regional office acts as both a sales center for business development, and a service center for finance, marketing, operation and human resources. Why Starwood can outperform some other hotel companies may be attributed to its core competence. There is some difference in hardware. For example, the reservation system of Starwood could be 20 years earlier than others and bigger in scale and good in quality. Another one is the standards, all its experience, corporate culture, software, and resources are implemented in all hotels. Decision-making on business development is also important because Starwood is quite aggressive to try its brand in China to succeed. Others came in 3-5 years later, while there were no more opportunities as the market share was already taken and it is difficult to penetrate and compete with. There may be some imitators in the market but the first mover can enjoy the advantages and later the efficiency on implementation will determine the market share. In addition, localization plays an important role in expansion, though some MNHCs realize the problem, they are already left behind.

4.13.2 Comparative advantages of indigenous hotel companies

The cost for MNHCs is much higher than domestic management companies, especially the management fees and salaries for expatriate managers. For example, the five-star Sofitel Yinzuo Hotel in Jinan managed by Accor spent RMB 10 million on labor costs of expatriate managers and management fee per year. Most hotel companies think that the advantages of the Chinese hotel management company are cheap price, with a management fee of 2.5% of revenue, and better understanding of the business environment in China. The low cost of the domestic management company is due to first, the payroll of the staff, as they use local people; second, the low management fee. After a certain period of time, if the domestic brands are acceptable, hotels will choose more domestic management companies.

MNHCs are more systematic and standardized in management, while indigenous hotel companies are more familiar with the local situation and the local market. The management plan of the indigenous company is more adaptable to the practice. Take the management model of the White Swan for example, the company think the set of operation system they created is more suitable for domestic hotels. From the point view of an interviewee, compared with a five-star hotel managed by Marriott, the system of Marriott cannot be simply copied to Chinese hotels, while the system of White Swan is easier for Chinese to use and understand. Marriott is a multinational company, which cannot think thoroughly and in detail about China. 80% of the staff of Marriott graduates from high school or university, while in China the ratio can be only 40%. Take training as an example, where to place a knife and fork on a table is common sense in USA, while there are no such things in China. Vacuum cleaners are very popular in foreign countries, but people in remote areas in China have never

seen them before. Training programs need to start from the very basic things in China, which some MNHCs never think of. The management model and operational manual of Marriott is more rigorous, but its management should be adapted to Chinese circumstance. For instance its techniques on conference sales may be very applicable in the US, but when applied to the Chinese conference organizers, especially the government agencies and state-owned enterprises, the operation needs to be revised for Chinese clients.

Compared with MNHCs, Gloria thinks that the advantages of domestic hotel management companies are better understanding of the Chinese environment and policies, easier communication, reasonable price and value for money. The obvious disadvantage is small distribution network. Generally if a hotel aims at the high-end or foreign market, it is more appropriate for a big MNHC. If aiming at the domestic market and intermediate level, a domestic hotel management company will be suitable.

It is interesting to find that some MNHCs have a more flexible localization strategy to cut costs and compete in the indigenous market. Bass implemented a localization policy in China that in its Beijing office there is no one foreign manager, from the human resources, finance to training department all staff are Chinese. But localization also has some negative impacts on the quality of service and the image of an international company. The company needs to balance the risk of degradation of service quality, the cost reduction and the effectiveness of management because finally customers care about quality and value for money.

From the MNHCs' view they are not optimistic about the expansion of indigenous hotel companies as there are always too much intervention from the government, low efficient mechanism and fierce competition. It is not easy for local Chinese hotel companies to expand because their brands are not famous and hotel assets cannot flow freely, which severely confines the development of the industry.

Among local hotel management companies, competition has also become fiercer. The market leader - Jinjiang, with the highest awareness in the market, aims to manage hotels in every province of China but is more constrained by the state-owned mechanism. Other hotel management companies are small in scale but relatively flexible in decision-making mechanism.

4.13.3 Competition after China's accession to WTO

Competitiveness of Chinese hotel management companies in the market, especially after China's entry into WTO is a major consideration of hoteliers. Since the opening up and reform, MNHCs entered the Chinese market experimentally, first in the high star hotels and occupied the field step by step. At the next stage, after China's entry into WTO, MNHCs may penetrate into the three-star and below hotels. Jinjiang Star now is a market leader in the economy hotel sector while the company worries about how to keep the position in the market and compete with MNHCs. The major threat is that MNHCs are rich in capital, brand, experience, and human resources. CTS Hotel Company worries that if Chinese hotel companies cannot strengthen their position, there will be no opportunities anymore, as MNHCs grow bigger and bigger but the indigenous hotel management companies become smaller and smaller and will be expelled from the market.

It is believed that after China's accession to the WTO more MNHCs will penetrate and have greater impact on state-owned hotels and independent hotels. They may not follow the traditional way of management, but massive expansion, perhaps by franchising. For example, Marriott didn't enter China ten years ago, but it soon acquired the New World Hotels and created a major presence in the Chinese market overnight. Under such circumstances Chinese hotel management companies should consider a workable approach for rapid expansion.

Independent hotels can feel the threat especially after China's accession to the WTO, if hotels do not go into chain operation, it will be very difficult for them to survive in the market. Some hotels are now improving their management and competitiveness through training and consultancy of management companies, but some hotels do not see any threat as they think they still have advantages in the market. Some hoteliers do not worry too much about the entry of more MNHCs after China's accession to the WTO because they think that the hotel industry is a capital intensive industry, MNHCs' expansion through management or branding is limited, and if they want to control more hotels, they need to invest huge amounts of money. It is important for Chinese hoteliers to improve their qualification and management through standardization, normalization, and institutionalization and to build their own characteristics, then expand nationwide.

Though some people think it is necessary and a must to establish the indigenous hotel chains in China because after China's entry into the WTO there will be no room for Chinese hotel industry. However there are some arguments that it is not the right

time for hotel chain formation in China and industry people should not be anxious about that, though many people expect the growth of indigenous hotel chains. The major constraint is that China is still an immature market and it is impossible to have a mature hotel chain in an immature market

4.14 Other issues

4.14.1 Strategy

It is critical for a hotel company to determine its strategy of positioning, branding and expansion. In history CTS registered two hotel management companies, one called Lido Hotel Management Company, another called CTS Hotel Management Company, but both failed. At the initial stage, the companies made out very ambitious business strategies aiming at large-scale, high-class hotels, competing with MNHCs. Consequently it was recognized that from human resources, technical support, to awareness in the market, the companies were not competent and finally failed (the better company survived three years, another only one year). As most hotel management companies are still in a primitive stage, they do not know which brand to create and which direction to go. After restructuring, CTS has changed its hotel management company to CTS Hotel Company and can export its management to other hotels.

The success of Jianguo depends on its expansion of brands out of Beijing and taking full advantage of its existing guest sources and marketing, especially return guests. In addition it depends on the support of its holding company, Beijing Tourism Group, for finance and human resources. Another important factor is the support of the

government as the environment is not a complete market economy in China. The Beijing Tourism Group was just split from the government and expansion needed the cooperation of other regional governments.

Some MNHCs also changed their strategy of expansion in China. Bass Hotels & Resorts will have more direct investment in hotel projects, and large-scale takeover of Chinese hotels as it has billions of cash in hand.

4.14.2 The role of government

It is quite interesting to find that there is paradox about the role of government in chain development. Most hotel management companies and hotels feel that government intervention disturbs their management and operation, which stunts the development of the hotel chain. However, most of them also expect government to play a more active role in conglomeration. This may be attributed to the state ownership system and the related mechanism and indicate that consolidation and conglomeration can only be implemented by government because most hotels are still regulated by various government agencies in China.

It is argued that chain formation in China by hotels or hotel management companies as a natural process is time-consuming and costly, perhaps before Chinese chains can be formed, all the hotels will be acquired by MNHCs. Based on market principles, powerful regulatory means should be used to restructure the hotel assets through merger/acquisition, consolidation and conglomeration to form nationwide hotel chains and improve the competitiveness of the new chains (Wei & Shen, 1999).

It is argued by some companies that government agencies like CNTA should support and accredit hotel brands, and provide funds for hotels' technology innovation. Some companies, especially state-owned ones, also suggest CNTA should consider to support several large state-owned companies and give them more preferential policies. However, some people argue that such contrived conglomeration by government may fail as it breaks market principles. Some hoteliers are quite pessimistic about the formation of indigenous hotel chains in China as there are many unfavorable factors in Chinese business environment, which cannot be removed quickly. China is still in the process of reform and transition, given the problems of the ownership and mechanism of state-owned enterprises, it is suggested that the formation of hotel chains should start from private enterprises. A brand in the market should grow naturally, not in a contrived way.

4.14.3 Hotel Associations

It is recommended by some hotel management companies that the recognition of hotel owners on chain operation is much more important than hotel managers, as hotel owners have more power on hotel issues but hotel managers can only implement the decision. CNTA or China Hotel Association should call on the hotel owners on this issue and build some connections between hotel owners and management companies. It is also necessary to improve the awareness of chain operation among Chinese hoteliers as some hotel managers are not quite familiar with the new business format and some people even do not know chain operation at all. In addition, it is suggested by some hoteliers that hotel associations should also be reformed. Currently there are three hotel associations in China - China Hotel Association under CNTA, China Hotel & Catering Association under Ministry of

Domestic Trade, and China Catering Association under Foreign Service Corporation. None of the three associations can reflect the complete picture of China's hotel industry. It is suggested the three associations should be merged to serve the hotel industry better.

4.14.4 New experiments in hotel chain development

4.14.4.1 Information Technology + branding + franchising

Some entrepreneurs are exploring new ways to accelerate the formation of hotel chains. For instance the Intec Group is experimenting with the use of more information technology. By analyzing the development of international hotel chains, the company found that expansion through assets involvement was slow. Some MNHCs e.g. Bass, Starwood and Hilton have entered the Chinese market for 10-20 years, but none of them have expanded to 30 hotels. It has taken a long time for these hotel companies to expand to their existing scale because there are many limitations in the traditional way of expansion. The strategy of Intec Group is first to create an Internet-based computerized management system for independent hotels, which is an integrated system of internal management and global distribution system; then, attract investors for necessary capital to promote the system across China; and last, build a unified brand for all these hotels and expand to more regions, even overseas.

The possibility for this plan is that the group's reservation system can operate for 800 member hotels and generate guest sources to hotels through the reservation network of the company every year. Together with the Bank of China, Citibank, and the Capital Information Technology Development Company, the company sponsored a tourism e-commerce network, which would unify the identities of the hotels and

market them through the network. The company thought that it was impossible to expand rapidly through asset involvement owing to the complicated ownership system in China. It is not realistic to take over a hotel and replace all the managers there, then the company changes its strategy from operational management of hotels to guest sources the use of network technology, as the company predicts that the network and e-commerce will have great impact on the hotel industry in the future. The company signed an agreement with one of the biggest software companies in China, Dongdong Software Company, to develop a hotel management system, which enables hotels to make reservation through the system and the company to operate and monitor hotels via network. The hotel management system co-developed by the company and Dongdong will assist them to penetrate and standardize the management of hotels. Through this kind of innovation to create a hotel chain by the advantages of network, the company aims at 100 hotels in the first stage, and to become China's largest hotel chain. But whether the company is capable, whether all the criteria permit, and whether people would accept this way is worth further examination.

4.14.4.2 Chain formation with the political administrative framework

Given the particular ownership system in China, it is recommended by some hoteliers to form hotel chains along with the political administrative framework by government departments or regional government. For example, each department or province could conglomerate its hotels into a chain e.g. the Oriental Hotel Management Company by the Bank of China, Beijing Tourism Group by Beijing government and Jinjiang Group by Shanghai government. This kind of formation is

easy to be implemented but often criticized by some hoteliers on its rationality and viability, as this kind of formation by government seldom grows successfully.

The White Swan Hotel Guangzhou is accepted as a member of the Leading Hotels of the World and can be regarded as a world-class hotel, but how the hotel can affiliate with hotels in other parts of China, like Beijing, Shanghai or Dalian will meet with many difficulties as hotels belong to different owners. It is suggested that the Guangdong government can learn from Beijing and Shanghai to combine most hotels in Guangdong to set up a group. If the White Swan Hotel can organize a hotel group directly under the Guangdong provincial government, the new hotel group can think about the strategy of development, the problems on capital operation, expansion by new construction, or takeover.

The reason why some hoteliers appreciate the practice of Beijing Tourism Group is that they think the approach is suitable and workable in the specific Chinese circumstance to form a group or chain. The conglomeration can form a good base and lay a solid foundation for the hotel company to grow, then the company can issue stocks and go public, which will optimize the asset structure of the company and improve its mechanism and performance.

4.14.4.3 Assets exchange program

Several regional hotel conglomerates are seeking ways to diversify their hotels to more places and network hotels as a nationwide chain. A method called “assets exchange” is discussed among these hotel companies. There are several conglomerate tourism companies in different provinces in China, e.g. Shanghai

Jinjiang Group, Beijing Tourism Group, Shaanxi Tourism Group, Guangdong Tourist Group, which all have big hotel companies. Most of these hotel companies belong to the local government or tourism administrations. The advantages of this kind of company are better management expertise, human resources and experience. But these regional hotel companies cannot satisfy the needs of chain operation and networking. Jinjiang Group has met Beijing Tourism Group to discuss the exchange of hotel assets between two companies, which will break the regional obstacles of both companies and enable them to diversify to other regions. In Beijing, the Tourism Group, which owned almost 30 hotels, would like to sell a hotel in Beijing to Guangzhou, and buy a hotel in Guangzhou, and then this hotel group can be networked as a chain.

Some hotel companies criticize the geographic concentration of hotels in one company in an area. For example, Xinya would like to expand outside, as most of its hotels are located in Shanghai. The company desired to exchange assets with some hotel companies in Beijing or other places to diversify its location and lower the risk. If assets exchange does not work, referral between hotels can also be considered to share guest sources. However, this depends on the reform of ownership and property rights and the ideas of hoteliers of different regions. Some hoteliers questioned that asset exchange would work in China owing to the complication of the ownership system as the relevant law, policy and market rules are not ready e.g. price, appraisal, liability, personnel and so on.

4.14.4.4 Joint venture hotel management company

A real estate company, Tianhong Group owns several hotels in Shanghai, Shenzhen, Hainan, Shandong, and Australia, plans to buy two hotels in Holland and the USA, and desires to expand to a hotel chain. Presently the company contracts its hotels to other hotel management companies. The company will continue to build hotels, while it may change the strategy and set up a hotel management company to operate its own hotels, quite similar to the way of Gloria Hotels. The company considers to establish a joint venture hotel management company with a MNHC, which will be a reciprocal plan for both parties, as the real estate company can get the management expertise and know-how of hotel operation, and the MNHC can expand in the Chinese market quickly. Xinya Group also thinks that setting up a joint venture hotel management company with a foreign hotel management company is worth trying. However, it is commented by some hoteliers that some joint venture hotel management companies have been tried in China, but no one can expand to a large scale.

4.14.4.5 Chain formation with name similarity

There are also some other proposals by independent hotels to form a chain through consortia or referral system without asset affiliation. For example, Shanghai City Hotel suggests that all the hotels named "City Hotel" in China joining together to create a chain with joint promotion, advertising, sales and training. These hotels in Beijing, Shanghai, Guangzhou, Hangzhou and Xi'an are almost of the same standard.

4.14.4.6 Overseas expansion

It is interesting to note that some hotel companies in China would like to expand overseas. For example, Tianhong Group took over one hotel in Australia and planned to buy two in Holland and the US. The Intec Group may expand to overseas hotels mainly catering to Chinese outbound travelers, for example in Thailand, Hong Kong, Singapore, and Australia in the future. Gloria planned overseas expansion two years ago to Singapore and looked seriously at Vietnam and North Korea, but finally terminated the plan to put priority on domestic development in China.

Some hotel companies experienced failure when expanding overseas, e.g. Jinjiang and Guangdong Tourist Group, which was attributed to human resources problems, for example, the managers sent out did not know the local customs, law, ethics and so on. In addition, the monitoring system on staff was also a problem.

With the development of China's outbound tourism, Chinese brands that can better satisfy the needs of Chinese travelers may emerge overseas. The booming outbound travel provides great opportunities for Chinese hotel companies to expand, and at the same time would help to reduce potential massive economic leakage.

Chapter 5 Conclusions and recommendations

5.1 Conclusions

This research aims to examine the development of hotel chains in China since 1978 and to make policy and operation recommendations for further expansion of hotel chains. It first explores and describes the historical and current situation of hotel chain development in China, and then a model of hotel chain formation is built to further examine the development of chain operation in the general hotel industry. Through the application of this model in China, certain opportunities are identified to discuss the necessity for and the viability of indigenous hotel chain development. Major issues and barriers in the process of hotel chain formation and expansion are also identified, which have some implications in the theory and practice of the hotel industry. Based on that, possible measures and strategic issues were further explored, which would assist in the future development of hotel chains, and at large, the hotel industry in China (figure 5).

Figure 5. Summary of conclusions based on results and findings

Conclusions	
Hotel chains in China	(1) At a preliminary stage; (2) Constrained by both the complicated business environment and the inadequate capability of hotel management companies
Pressure	(1) Fiercer competition; (2) Increased pressure from both the internal and external
Environmental scan	(1) More productive opportunities for chain development; (2) Complexity of the ownership system and the paradox of the economic mechanism; (3) Weak and inadequate legal framework; (4) Non-market policies and regulations; (5) Local protectionism; (7) Eccentric business culture.
Organizational capability	(1) Weakness on management model, distribution channel, branding and network; (2) Lack of resources to formulate organizational capability: financial, human resource, expertise.
Forms of chain formation	(1) Management contract and direct investment are used most often; (2) Consortia and referral system are tried; (3) Franchising, merger/acquisition seldom achieves.
Management and operation	(1) Hotel owner's intervention; (2) Dispute on contract; (3) Relatively short contract duration; (4) Communication between hotel owner and operator;

5.1.1 Hotel chain development in China

Since the creation and growth of the tourism industry in China after its opening to the outside world, the hotel sector experienced fast growth and dramatic changes in the last two decades. However, as an emerging destination and a developing market, the hotel industry in China is generally a fledgling one. The milestones of overprovision of hotels, introduction of star-rating systems and the participation of foreign investment and management have had great impact on the industry. Compared with some developed countries, the hotel industry in China is in a much more complicated situation in terms of quantity and quality, ownership system, star level, regional distribution, and performance.

The first influx of inbound tourists brought with it multinational hotel chains, which changed the management and operation of the traditional Chinese hotel industry. The involvement of MNHCs in China's hotel industry helped to ease the shortage of hotel provision and improve the service and management quality of the hotel industry, and change the concept of the industry as a whole. However, this also led to the heavy reliance on foreign management and the dominance of the MNHCs in China's hotel market.

The emergence of indigenous hotel chains in China is the result of both the adaptation of foreign management and great market potential in China. Technology transfer in the hotel industry enables the local hotel companies to form and manage some hotel chains, and these chains can expand to a certain scale owing to the fast growth of the hotel industry and the search for better management skills among hotels in China. But generally the development of these indigenous hotel chains is still in a preliminary stage and their growth is constrained by both the complicated business environment in the country and the inadequate management capability of the hotel management companies.

5.1.2 The model of hotel chain formation and its application in China

The proposed model is based on the two parties in the process of hotel chain formation - hotel management companies and independent hotels. The model identifies and examines the major factors for both parties and how these factors interact during the course of chain formation. Domains of this model are identified as: external pressure, internal pressure, environmental scan, organizational capability,

assessment of availability, form of alliance, and management/operation (The model is shown on page 55).

The arising external pressure and the internal pressure force hotel management companies and independent hotels to seek ways for survival and development in the market. The hotel management company scans the environment and builds its competence to expand its business and attract more hotels to its pool, while independent hotels may be forced to consider going into chain operation or not surviving in the market. After a two-way assessment of each other, the two parties may reach a mutual direction and find a suitable format for chain formation. Through adaptation and integration in the management and operation the chain can be developed and expanded to a large scale. The model is further examined and developed in the context of China's hotel industry, with each factor of these domains being reformulated through the primary data results. This model is of significance to the hotel industry as both hotel management companies and independent hotels in China did not have a clear picture of chain formation.

Applying this model to the specific circumstance in China's hotel industry, it is found that the increasing external and internal pressure are driving the hotel industry towards a certain degree of consolidation and restructuring, with the emerging hotel management companies searching for growth and expansion. The pressure comes mainly from the further reform of the economic system toward a market-orientation and the increasing competition in the hotel industry.

Through environmental scan, the productive opportunities for hotel chain formation in China can be identified by the possible signs of the fast growth of hotel properties and the need for management expertise, which provide good opportunities for hotel management companies to manage or takeover to form chain. The rise of domestic tourism and outbound tourism provides great demand for relevant accommodation facilities, which are possibly good business opportunities to start hotel chains. Some hotel sectors, e.g. resort, hostel, and motel, have provided great opportunities for chain expansion. In terms of location, the developing areas in China, where the tourism industry is just emerging, have more potential for hotel chain development.

The environmental scan also reveals some major environmental issues constraining the hotel chain formation in China. These are: the complexity of the ownership system and the paradox of the economic mechanism; weak and inadequate legal framework; non-market policies and regulations; local protectionism; and, the eccentric business culture.

The examination of the organizational capability of the hotel management companies in China showed most companies are aware of their weakness and emphasizes more on the management model, distribution channel and networks, and branding of their hotel products. However, owing to the lack of financial, human resources and other expertise, the building of the organizational capability of Chinese hotel companies is still at a preliminary stage. The weakness of the organizational capability influences the assessment of independent hotels on hotel management companies for their availability in chain operation.

In terms of forms of hotel chain development, there are traditional hotel groups, government conglomerations and hotel-based management companies. Generally the forms of management contract and direct investment are often used for expansion. Hotel consortia and referral systems are tried in China but seldom to expand to a large scale. Franchising and merger/acquisition are difficult to achieve. However, given the fast changing economy in China, these forms have emerged and may be developed soon in the future. In addition, many new forms of chain formation are also being experimented with in the hotel industry. These include assets exchange program among hotels, joint venture hotel management companies, and the adoption of new information technology, etc.

In management and operation issues in a hotel chain, the relationship between the management team and hotel owners are critical to the success and survival of this chain. While in China, the hotel owner's intervention, and dispute on contract, relative short contract duration, and the communication between two parties could be challenges to hotel chains.

5.2 Recommendations

Owing to the political, economic, social, and cultural complexity in China, both the business environment changes and the emerging 'productive opportunities' offer new opportunities for hotel chains' expansion. More substantial reforms in China's economic system and the integration of resources to build the organizational capability of the hotel chains are urgently needed for the formation and expansion of Chinese hotel chains. Based on the above listed results and findings, the following sections identify recommendations for the three main stakeholders in China's hotel

industry: regulatory bodies, hotel management companies, and, independent hotels. Finally, recommendations for future research are given, followed by some limitations of this study (figure 6).

Figure 6. Recommendations from the results and findings

Recommendations	
Recommendations to hotel management companies	(1) Developing organizational capability of Chinese hotel management companies; (2) Environmental scan for productive opportunities; (3) Acquisition and integration of resources.
Recommendations to independent hotels	(1) Further improvement on management and performance; (2) Serious consideration on chain operation for survival; (3) Building knowledge base on chain operation.
Recommendations to regulators	(1) Further reform on the economic system and the establishment of a competitive mechanism; (2) Rationalization of legislation and regulations;

5.2.1 Recommendations for the hotel industry

5.2.1.1 Recommendations for regulators

5.2.1.1.1 *Further reform on the economic system*

As China is in a transition period from the previous planned economy to market economy, it still lacks the essential market principles and relevant rules, legislation and the mechanism of a market economy. The macro environment has great impact on the hotel industry. The critical issues revealed in this research indicate the industry's urgent need for a better business environment, which may require the legislators and regulators to pay attention to these issues in the future.

Given the complexity of the ownership system in China and the maze of decision-making mechanisms caused, further reform of state-owned hotels is needed. Splitting hotel assets from government agencies is a basic step, while more effective ways to

turn these bureaucratic organizations into competitive firms should be exploited. Reform of the sole state-owned hotels into limited liability companies or stock companies should be boosted. Relevant issues in the state-owned hotels such as personnel management, and salary policies should also be reformed to create more dynamic organizations.

It is necessary to ease the restrictions on the free flow of state-owned hotel assets and set up a property rights exchange market for the industry, which would optimize hotel assets and enable more active capital participation in the hotel sector. Direct investment or merger/acquisition could play a more effective role in chain formation. A free asset market would also streamline concentration, consolidation and conglomeration in the industry, which may break through the existing fragmented hotel industry with its regional and administrative barriers. Chain formation by government should be approached cautiously as it is a double-edged sword: it may speed up the process of chain formation, but it may ruin hotel assets and create new regional protectionism.

5.2.1.1.2 Rationalization of legislation and regulations

The enormous regulations produced by different government departments confine the further development of hotel chains, which include regulations on labor, price, foreign exchange, salary, and public security issues, etc. Review of outdated regulations with a view to amending them according to the changing economic development could streamline the operation of hotel companies. More importantly, coordination among government agencies and better communication with the hotel

industry should be set up to avoid the contradiction and confusion of the regulations, which often harass the hotel industry.

As the market economy is just starting in China, the lack and inadequacy of laws and regulations e.g. franchising and intellectual property rights, also confuse the hotel chain operators. There is an urgent need to call for new rules in the hotel industry. In China's weak legal system, the obedience and enforcement of relevant laws should also be promoted as any disputes on contracts in chain hotels may marginally increase the transaction cost of hotel companies.

In addition, at the current stage government still has great impact on the hotel industry. If possible, more incentives or guidelines for hotel chain development by government industry policies would be welcome.

5.2.1.2 Recommendations for hotel management companies

5.2.1.2.1 Developing organizational capability for management companies

Although indigenous hotel management companies have grown up in recent years, their capability, performance, and competitiveness are still weak in the market. Compared with MNHCs, which have stronger brands, complete supporting systems, worldwide distribution network, and systematic management model, the indigenous hotel companies can only take the advantage of familiarity with the local market and cheap prices. Through technology transfer, most hotel or hotel companies in China have developed their management model or operation manual, but for chain operation they still need to be upgraded to an international standard, whilst keeping adaptability and flexibility in the special Chinese circumstances. In addition, how to

turn effective management and qualified products and service into a more recognizable brand in the market should also be addressed. Chinese hoteliers identify distribution channel or reservation network as a big gap between indigenous hotel companies and MNHCs. Making progress on this aspect should be a priority. The adoption of the newly emerging information technology may offer some assistance.

5.2.1.2.2 Environmental scan for productive opportunities

Indigenous hotel companies should develop their environmental scan plan to explore the environmental changes in the market and take the opportunities of further economic reform in China and the resultant productive opportunities. This is especially important as the hotel market will be more open after China's accession to the World Trade Organization, and the business environment will change drastically, though gradually.

5.2.1.2.3 Acquisition and Integration of resources

Due to the inflexible mechanism and the fussy regulations in China, Chinese hotel companies may be inefficient, ineffective in operation and find it difficult to acquire necessary and adequate financial, human and other resources to create their capability in growth and expansion. For example, some resources are not commercialized according to market principles, and some regulations limit the free flow of resources e.g. the personnel management in state-owned hotels. More business acumen and adaptability should be exploited to get essential resources, and integrate these resources into productivity and services for Chinese hotel chains.

5.2.1.3 Recommendations for independent hotels

5.2.1.3.1 Further improvement on management and performance

Though modern hotels have developed for many years in China, most local independent hotels are still poor in management and weak in developing their competence. Whether to join a chain operation or keep independent, the most critical issue for the local independent hotels is to further improve its management capability and performance in the market, which will improve the competitiveness of the hotel industry at large and streamline the possible future chain formation.

5.2.1.3.2 Serious consideration on chain operation for survival

Given the rapid increase of hotel rooms and the fierce competition in the hotel industry, together with more opening up of Chinese hotel market, how independent hotels survive in the future will be a big problem for hotel owners. The obvious advantages of chain operation on economy of scale, lower transaction cost, brand name, purchasing power, distribution channel may force those independent hotels that cannot keep their uniqueness and market share in the industry into embarrassment. If they cannot get bigger, be part of a bigger may worth serious consideration in their future development.

5.2.1.3.3 Building knowledge base on chain operation

The concept of chain operation has rooted in China for two decades. Though technology transfer enabled the local hotelier to operate and manage an individual hotel, local hotels still lack the knowledge of chain operation, especially the development of their management model, building of distribution channel, branding and networking and the recruiting essential financial and human resources for

consolidation in the hotel industry. Improvement in this kind of business mentality is essential among independent hotels, which will stimulate hotels to grow into hotel management companies, or assist independent hotels to better perform in joining chain operation.

5.2.2 Recommendations for future research

5.2.2.1 Further development of the model

The model developed in this research is based on two parties – hotel management companies and independent hotels, and tries to describe and explain the process of hotel chain formation and the relevant issues involved. The background theories are mainly theory of growth, theory of organization, management and economics. It is suggested that the model be further examined, refined and developed in the future studies based on an even wider range of background theories such as public policy, law etc.

5.2.2.2 More examination on hotel chains

This research examined the hotel chain development in China and addressed the major issues related to chain formation and expansion. Those factors focused mainly on environment, motivation and organization domain, and some socio-culture issues emerged and were discussed. As hotel chain formation is quite a complicated activity, more examinations are still needed to explain this phenomenon, such as financing, strategic management, human resources management, etc.

5.2.2.3 A bigger sampling size needed

As this research is a descriptive qualitative research, there are only 26 interviewees, which represent hotel management companies, independent hotels and tourism administrations involved. A larger sample quantitative research may be necessary to further examine the factors identified in this research.

5.3 Limitations

5.3.1 Generalization

In this research there are only 26 interviews. Although they represent a range of hotel companies and hotels in China, it may not be possible to use them to make generalizations for the whole hotel industry.

5.3.2 Research methodology

This research deployed qualitative methods, which are quite descriptive and consist of several cases. To some degree the accuracy and reliability of the data may be influenced as the interviewers reaction and response to each question may vary due to the availability of interview time, their knowledge and understanding about these issues.

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Appendices

Appendix A

Pilot Interview Questions

Questions for Hotel Management Companies

10. Can you briefly describe the historical development of your hotel management company?
11. How about the current situation of your hotel management company in terms of (a) size; (b); speed of expansion; (c) performance?
12. What drives your company to expand and grow, from both the internal and external?
13. Do you scan business environment when expanding? If do, what factors influence the growth and expansion of your hotel management company?
14. Which kind of way do you use to expand e.g. direct investment, merger/acquisition, management contract, franchising, consortia, referral system, or any other? Why do you use that form?
15. How do you operate and manage your hotel management company?
16. How do you manage the hotels in the chain?
17. What are the factors influencing the expansion and growth of your company?
18. What is the future development plan and strategy of your company?

Questions for Independent Hotels

11. Would you please briefly describe you hotel in terms of its history, investment, facilities and performance?
12. How is the business environment of your hotel, from both the internal and external?
13. Are you willing to join a hotel chain? Why or Why not?
14. How do you compare the differences between chain-operated hotels and independent hotels?
15. What are the major considerations in joining chain operation?
16. If go chain-operation, what factors will you consider to choose a hotel management company?
17. Which kind of way will you choose to join a chain e.g. direct investment, merger/acquisition, management, franchise, consortia, and referral system? Why?
18. What are the emerging issues in the operation and management to a hotel after joining a chain?
19. What are the factors influencing an independent hotel to join a chain?
20. What is the plan or strategy for your hotel's future development?

Appendix B

Profiles of the Pilot Interview organizations

1. **Bass Hotels & Resorts China.** Bass Hotels and Resorts, a multinational hotel company headquartered in UK, entered China in 1984. Now the company manages 26 hotels in 19 cities in China with more than 9,000 rooms.
2. **China National Tourism Administration (CNTA).** CNTA is a government agency responsible for developing, promoting and regulating China tourism industry. The Industry Development Department under CNTA is responsible for hotel planning, star rating, and development nationwide.
3. **China Travel Service Hotel Company.** A subsidiary of China Travel Service (CTS), one of the largest state-owned tourism firms in China. The CTS Hotel Company CTS operates 14 hotels across the country, varying from five-star to two-star.
4. **Hademen Hotel.** A state-owned independent hotel under the Commercial Commission of the Chongwen District, Beijing Municipal Government. The three-star property was opened in 1974, with 229 rooms.
5. **Intec Group.** An internet-service and hotel reservation service providing company in Beijing. The company is trying to sponsor a hotel chain in China with the assistance of its IT technology.
6. **Kempinski Hotel.** A Sino-Germen joint venture hotel under the management of Kempinski Hotels and Resorts, Germany. The 486- room five-star property was opened in
7. **Oriental Hotel Management Company.** A hotel company established by the Bank of China to operate all the hotels belongs to the bank. The company manages 11 hotels in Shenzhen, Zhuhai, Huizhou, Haikou, Shantou, Chaozhou, Dalian, Qingdao, Guilin, Baoding, and Suzhou, mostly four-star and above properties.

Appendix C

Second Phase Interview Questions

Questions for Hotel Management Companies

1. Can you briefly describe the origination and the historical development of your hotel management company?
2. How about the current situation of your hotel management company in terms of (a) size; (b); speed of expansion; (c) performance?
3. What drives your company to expand and grow, from both internal and external factors?
4. Environment issues:
 - Do you scan business environment when expanding? If do, what factors influence the growth and expansion of your hotel management company?
 - How do government policies and regulations influence hotel chain development?
 - What could be improved in the environment for hotel chain development?
 - How do you evaluate the competition between hotel management companies?
 - How do you evaluate the competitiveness of Chinese hotel management companies vs. MNHCs?
 - How do you think about the impact of China's entry into WTO on hotel chains in China?
5. Ownership and mechanism
 - What is the ownership type of your company?
 - How is the decision made in such an ownership system?
 - How does the ownership type affect the growth and expansion of your chain?
 - Is the management right separated from the ownership? Why or why not?
 - Which type of hotel would you like to manage? Why?
6. Formation issues
 - Which kind of way do you use to expand e.g. direct investment, merger/acquisition, management contract, franchising, consortia, referral system, or any other?
 - Why do you use that form?
7. Management and operation issues
 - Do you have a management model or management style in your company? If yes, can you describe it?
 - How do you look on branding for hotel chains? Do you have a branding strategy? If yes, what is your branding strategy?
 - How do you finance for chain development?
 - How do you operate and manage your hotel management company?
 - How about the application of technologies in your hotel chain?
 - How do you manage the individual hotels in the chain?
 - What are the factors influencing independent hotels joining your chain?
 - How is the effectiveness of your management in those hotels? What are the major achievements and barriers?

- What are advantages and disadvantages of your company?
- 8. Strategy issues
- What are the factors influencing the future expansion and growth of your company?
- What is the future development plan and strategy of your company?

Questions for Independent Hotels

1. Would you please briefly describe you hotel in terms of its history, investment, facilities and performance?
2. Are you willing to join a hotel chain? Why or Why not?
3. How is the business environment of your hotel, from both the internal and external?
4. How do you compare the differences between chain-operated hotels and independent hotels?
5. What are the major considerations in joining chain operation?
6. If joining a hotel chain, what will you consider to choose a hotel management company?
7. Which kind of way will you choose to join a chain e.g. direct investment, merger/acquisition, management, franchise, consortia, and referral system? Why?
8. What are the emerging issues in the operation and management to a hotel after joining a chain? Why is that important to your business?
9. How will you deal with the relationship with the hotel management company after their management?
10. What influence your hotel to join a chain?
11. What are the major difficulties or problems for your hotel business?
12. What is the plan or strategy for your hotel's future development?

Appendix D --Tables

Table 1. Hotel management companies in China

Name	Headquarter
China Travel Service Hotel Management Company	Beijing
Hualong (International) Hotel Management Co. Ltd.	Beijing
Sheraton Oriental Hotel Management Company	Beijing
Liuhexing Hotel Management Company	Beijing
Jianguo Hotel Management Co. Ltd.	Beijing
Jinhui Hotel Management Company	Beijing
Xingxi Hotel Management Company	Beijing
COSCO Hotel & Property Management Company	Beijing
Poly Property (Hotel) Hotel Management Co. Ltd.	Beijing
Hong Kong China Travel Service Hotel Management Company	Beijing
Ever bright International Hotel Management Company	Beijing
Huameilun Hotel Management Company	Beijing
Jinjiang Group Hotel Management Company	Shanghai
Huating Group Hotel Management Company	Shanghai
Xinya (Group) Hotel Management Company	Shanghai
Hengshan Group Hotel Management Company	Shanghai
Yan Capital Tourist Hotel Management Company	Hebei
Triones Hotel Management Co. Ltd.	Liaoning
Taiga Hotel Management Service Company	Dalian
Continental Hotel Management Company	Dalian
Fulihua Grand Hotel Management Company	Dalian
Jinlin (International) Hotel Management Company	Nanjing
Xuanwu Hotel Management Company	Nanjing
Mandarin Hotel Management Company	Xianmen
Fuhua Hotel Management Company	Shandong
Haitian Grand Hotel Management Company	Qingdao
Jiangnan Hotel Management Co. Ltd.	Wuhan
Huatian Hotel Management Company	Changsha
White Swan Hotel Management Company	Guangzhou
Oriental Hotel Management Company	Guangzhou
Pearl River Property & Hotel Management Company	Guangzhou
Yuanyang Hotel Management Co. Ltd.	Guangzhou
Zhuhai Hotel Management Company	Zhuhai
Golden Bay International Hotel Management Company	Shantou
Jiayi Hotel Management Company	Ugandan
Zhuhai Resort Hotel Management Company	Guangdong
Guangxing Hotel Management Company	Guangdong
Sichuan Jinjiang Hotel Management Company	Sichuan
Comfort Hotel Management Center	Yunnan

Source: CNTA, 1998.

* Due to the limitation of source, hotel numbers and rooms are not available.

Table 2. Increase of hotels compared to tourist numbers and hotel profit

Year	Hotel rooms		Inbound tourists		Room occupancy (%)	Profit rate (%)
	Number	Growth (%)	Number	Growth (%)		
1993	386,401	10.07	41,526,900	8.95	67.70	9.44
1994	406,280	5.14	43,684,456	5.20	62.20	9.82
1995	486,114	19.65	46,386,511	6.20	58.12	6.51
1996	594,196	22.23	51,127,516	10.20	55.27	4.59
1997	701,736	18.10	57,587,923	12.60	53.80	1.00
1998	764,800	9.00	63,478,400	10.23	51.70	-5.84
1999	889,430	16.30	72,795,600	14.68	53.41	--

Source: CNTA 1995-2000

Table 3. The world's largest 20 hotel chains

Rank	Hotel chain	Headquarters	Rooms	Hotels
1	Cendant Corp.	1 Parsippany, NJ USA	542,630	6,315
2	Bass Hotels & Resorts	London, England	471,680	2,886
3	Marriott International	Washington, D.C. USA	355,900	1,880
4	Accor	Evry, France	354,652	3,234
5	Choice Hotels International	Silver Spring, MD USA	338,254	4,248
6	Best Western International	Phoenix, AZ USA	313,247	4,037
7	Hilton Hotels Corp.	Beverly Hills, CA USA	290,000	1,700
8	Starwood Hotels & Resorts Worldwide	White Plains, NY USA	217,651	716
9	Carlson Hospitality Worldwide	Minneapolis, MN USA	114,161	616
10	Hyatt Hotels/Hyatt International	Chicago, IL USA	85,743	195
11	Wyndham International	Dallas, TX USA	73,215	303
12	Sol Meliá	Palma de Mallorca, Spain	69,178	260
13	Société du Louvre	Paris, France	65,970	990
14	Hilton International	Watford, Herts, England	61,889	217
15	Forte Hotel Group	London, England	58,636	449
16	FelCor Lodging Trust	Irving, TX USA	50,000	188
17	TUI Group	Hannover, Germany	42,379	172
18	La Quinta Inns	San Antonio, TX USA	39,250	302
19	Extended Stay America	Fort Lauderdale, FL USA	38,300	362
20	Club Méditerranée SA	Paris, France	36,510	127

Source: Hotels, July 2000, pp.50

Table 4. MNHCs in the most Countries

Hotel company	Countries
Bass Hotels & Resorts	98
Best Western International	84
Accor	81
Starwood Hotels & Resorts	80
Carlson Hospitality Worldwide	57
Marriott International	56
Hilton International	53
Forte Hotel Group	51
Club Méditerranée SA	40
Choice Hotels International	36
Hyatt Hotels/Hyatt Intl	35
Sol Meliá	27
Airtours Group	23
Cendant Group	23
Hilton Hotels Corp.	20

Source: Hotels, July 2000, pp.43

Table 5. Hotel increase in China from 1980-1999

Year	Hotels	Rooms	Room+%
1980	203	31,788	-
1981	296	43,251	36.06
1982	362	51,625	19.36
1983	371	59,588	15.38
1984	505	76,994	29.21
1985	710	107,389	39.47
1986	974	147,479	37.33
1987	1,283	184,710	25.24
1988	1,496	220,165	19.19
1989	1,788	267,505	21.50
1990	1,987	293,827	9.83
1991	2,130	321,116	9.28
1992	2,354	351,044	9.32
1993	2,552	386,401	10.07
1994	2,995	406,280	5.14
1995	3,720	486,114	19.65
1996	4,418	594,196	22.23
1997	5,201	701,736	18.10
1998	5,782	764,800	9.00
1999	7,035	889,430	16.30

Source: CNTA 1981-2000

Table 6. Star hotels by region in 1999

Province	Star hotels total	Five star	Four star	Three star	Two star	One star
Heilongjiang	122	1	-	30	51	40
Jilin	94	2	2	33	47	10
Liaoning	169	2	8	61	72	26
Beijing	277	17	32	71	120	37
Tianjin	53	1	5	27	17	3
Inner Mongolia	55	-	-	16	31	8
Shanxi	67	-	2	25	39	1
Hebei	141	-	4	57	71	9
Shanghai	138	10	17	53	48	10
Jiangsu	247	2	20	95	120	10
Anhui	98	-	1	35	53	9
Zhejiang	252	-	12	94	131	15
Fujian	148	4	3	56	79	6
Shandong	166	3	10	75	61	17
Hubei	163	1	7	60	77	18
Hunan	161	3	3	45	87	23
Guangdong	455	15	39	172	205	24
Guangxi	90	4	4	33	45	4
Hainan	59	3	11	30	12	3
Jiangxi	69	-	2	25	35	7
Henan	126	-	2	44	78	2
Xinjiang	82	2	3	13	54	10
Gansu	51	-	1	16	29	5
Ningxia	8	-	-	1	7	-
Shaanxi	66	4	5	26	28	3
Tibet	19	-	-	7	7	5
Qinghai	10	-	-	2	4	4
Chongqing	42	-	2	15	22	3
Sichuan	126	2	2	34	76	12
Guizhou	43	-	2	6	22	13
Yunnan	43	-	2	6	22	13

Source: CNTA 2000

Table 7. Performance of hotels by star-rating in 1999

Hotel type	No. of hotels	No. of rooms	No. of beds	% to total rooms	Room occupancy (%)	Total revenue (RMB0000)	Fixed assets (RMB0000)	Index * (room revenue/room fixed assets)
5 star	77	36,160	60,050	6.89	61.41	1,058,518.80	2,738,903.84	2.59
4 star	204	66,689	117,427	12.71	58.96	1,240,373.10	3,520,612.33	2.84
3 star	1292	206,905	400,503	39.42	55.43	2,105,152.60	6,192,559.62	2.94
2 star	1898	187,899	387,848	35.80	50.76	965,801.55	2,746,186.25	2.84
1 star	385	27,241	59,038	5.19	46.14	93,634.76	334,092.20	3.57

Source: CNTA 2000

* Figures calculated based on CNTA data

Table 8. Performance of hotels in China by ownership type in 1999

Ownership type	Number of Hotels	Number of rooms	Number of beds	Room occupancy (%)	Total revenue (RMB0000)	Fixed assets (RMB0000)	Index *(room revenue/room fixed assets)
Total	7,035	889,430	1,769,825	53.41	8,457,488.88	23,694,044.13	2.80
State-owned	4,512	543,146	1,104,669	51.45	3,743,793.34	10,456,514.78	2.79
Collective	1,003	85,284	177,468	50.41	620,174.19	1,864,242.61	3.01
Private	174	12,910	25,716	52.14	86,928.89	235,006.65	2.70
Alliance	223	57,282	112,566	62.42	849,146.70	1,635,181.2	1.93
Stock	404	50,635	97,909	53.39	470,102.07	1,554,162.08	3.31
Foreign-invested	472	90,841	162,223	57.46	1,759,579.01	5,755,066.94	3.27
Hong Kong, Macau, Taiwan-invested	247	49,332	89,274	58.4	927,754.68	2,193,869.87	2.36

Source: CNTA 2000

* Figures calculated based on CNTA data