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Hotel Rebranding and Rescaling

Effects on Financial Performance

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An exploratory study of ninety-five hotels that rebranded or rescaled their operations revealed the possibility of long-term financial benefit after the change. In many cases the hotels saw an initial decline in financial results, but that was followed by a gradual recovery. Hotels that moved upscale generally saw increases in average daily rates. Hotels that merely changed brands without also changing their scale reported no significant change in financial results.

Keywords: hotel rebranding; hotel financial performance; hotel obsolescence

An appropriate brand and correct positioning are key drivers of success in the hotel industry (Jiang, Dev, and Rao 2002; Ambler et al. 2002; Brady, Bourdeau, and Heskel 2005; Leone et al. 2006; Kayaman and Arasli 2007). Consequently, hotel owners sometimes find it necessary to rebrand their property (changing from one chain name and system to another) or rescale the hotel (changing from a brand in one market segment to a different one). Making such a change is especially important when a hospitality property has lost effectiveness in serving its market, whether due to obsolescence or to market changes (Frigo 2002; Wänke, Herrmann, and Schaffner 2007; Kwortnik 2006; Lei et al. 2004). A common reason that a hotel may need to change its brand affiliation or its market scale (most commonly, moving down market to a different brand) is when there are changes in market demand (Lomanno 2006). Each year between 2002 and 2006, for example, an average of approximately fifteen thousand hotel rooms were converted to luxury and upper upscale hotel chains, eleven thousand to upscale flags, thirty thousand to midscale brands with food and beverage, twenty thousand to midscale chains without food and beverage, and thirty-five thousand to economy flags

Exhibit 1:
Examples of hotels by scale segment

Luxury
Four Seasons
Ritz-Carlton
Saint Regis
Upper Upscale
Embassy Suites
Hyatt
Marriott
Westin
Upscale
Courtyard
Doubletree
Homewood Suites
Radisson
Residence Inn
Wyndham
Midscale with food and beverage
Best Western
Clarion
Holiday Inn
Howard Johnson
Quality Inns and Suites
Ramada
Midscale without food and beverage
Comfort Inns & Suites
Fairfield Inn
Hampton Inns & Suites
Holiday Inn Express
La Quinta
Springhill Suites
Economy
EconoLodge
Knights Inn
Microtel Inn
Motel 6
Super 8
TraveLodge

Source: Smith Travel Research.

(Lomanno 2006). To analyze the effect of such hotel brand changes, this research bases its analysis on the hotel chain scale segments promulgated by Smith Travel Research (STR), namely, luxury, upper upscale, upscale, midscale with food and beverage, midscale without food and beverage, economy, and independent. Examples of brands included in each chain scale segment are presented in Exhibit 1.

Changes in brand and scale can affect average daily rate (ADR), occupancy rate, RevPAR (revenue per available room), and profit, as well as operating and capital

costs. So a critical question for hotel owners is whether the decision to make the necessary expenditures for rebranding will enhance financial performance enough to justify the costs. This critical question has not yet been empirically analyzed despite the many hotel brand and scale changes that we just mentioned (Lomanno 2006). Although there is a body of research about the effects of brand affiliation on hotel market value (O'Neill and Xiao 2006) and brand equity on hotel financial performance (W. G. Kim and Kim 2004; H. B. Kim and Kim 2005; O'Neill and Mattila 2005), we have found no empirical study that systematically examines how a hotel property's brand or scale change affects its financial performance.

This exploratory study explores the effect of brand and scale changes on hotels' financial performance. In repositioning a hotel, its scale may be moved downward (such as luxury to upper upscale) or upward (such as economy to midscale without food and beverage), or its brand may be changed even though its market scale does not change materially (for instance, from Holiday Inn to Best Western). Based on a data set for the years 2003, 2004, and 2005 provided by STR, this study analyzes detailed information regarding hotels' original market position and their changed scales, along with financial results. We explore the effect of brand and scale changes on hotel financial performance during this period of consistent economic growth. Through this exploratory study, we hope to assist hotel owners and managers in understanding the effects of changing a hotel's brand or market scale on its financial performance.

Effects of Scale or Brand changes on Hotel Performance

For the 1,960 U.S. hotels in our initial set, STR provided ADR, occupancy, RevPAR, net operating income (NOI), and marketing expenses for the three-year study period. As of 2005, the mean ADR for these hotels was $103, occupancy was 70.8 percent, RevPAR was $74, NOI was $3,319,421, and marketing expenses were $689,938. The mean number of rooms for these 1,960 hotels was 218 rooms, and the mean age was 18 years. Although this did not figure into our analysis, STR also specified the location for each hotel (that is, city, suburban, highway, airport, or resort).

Of the 1,960 hotels in the sample, 138 hotels changed their brands or market scales during the study period. For hotels that changed brands or scales, the data indicate their previous scales and the date when brand or scale changed. For reasons that we explain below, we excluded 43 hotels, leaving a test sample of 95 hotel properties. With a mean of 168 rooms, the properties in the 138-hotel subgroup were slightly smaller on average than the full sample, but their mean age was the same. As of 2005, the remaining 95 hotels had 189 rooms on average and their mean age was 19 years old. Their mean NOI was $1,461,277, mean ADR was $78.09, and mean occupancy was 63.2 percent.

The matrix presented as Exhibit 2 shows that hotel properties that changed brands or scales before or during the third quarter of 2003 were disqualified from the analysis. We excluded the forty-three hotels from our sample for the following reason. If a particular year's performance was favorable, the hotel would be likely to enjoy positive performance in the following year regardless of whether it changed its brand or scale. Thus, we wanted to include a consideration of a hotel's financial performance before any brand or scale changes as part of our examination of the influence of any brand change on a hotel's financial performance. We also needed to take into account the fact that the change

Exhibit 2:
Scale/Brand Change Month and Year Matrix

	Year Influenced by the Change			
Time of change	t	t + *1*	t + *2*	t + *3*
January 2003–September 2003		2003	2004	2005
October 2003–September 2004	2003	2004	2005	
October 2004–September 2005	2004	2005		

Note: t = before rebranding/rescaling; $t + 1$ = year immediately following the change; $t + 2$ = two years after the change; $t + 3$ = three years after the change.

in brand or scale for the ninety-five hotels in our sample could have occurred at any time during the year. Consequently, the operating results for a hotel that changed its scale at the beginning of 2003 reflected all twelve months of that year, but that was not the case for a hotel that changed at the end of that year. Thus, our data had to take into account the month of any change within a particular year. We believe it would be misleading to use 2003 ADR to measure performance changes if a hotel was rebranded or rescaled late in 2003, for example, because the year-end 2003 financial report would not give a full accounting of that change. Thus, the cutoff point a for brand or scale change in our data was during the third quarter of a year. If changes occurred by the end of the third quarter, we believe the remaining months would sufficiently influence the hotel's annual performance. It is possible that when the hotel changed its brand or scale during the fourth quarter, the effects of the change would most likely be reflected no sooner than the subsequent year.[1]

Looking at the operating ratios for the ninety-five hotels remaining in our sample (Exhibit 3), we note the relatively high correlation between number of rooms and marketing expenses. This reflects the common industry knowledge that larger operations require more promotions, advertising, and employees in the marketing department to formulate and implement marketing strategies and programs. Number of rooms and marketing expenses had high correlations with financial performance variables, such as NOI and ADR, consistent with previous research that showed significant relationships between hotel size and financial performance (O'Neill & Mattila 2004; Hansen and Wernerfelt 1989) and between marketing-related expenditures and financial performance (McAlister, Srinivasan, and Kim 2007; Graham and Frankenberger 2000).[2]

The most common market scale change was downward, a move made by nearly half of the sample hotels. We found that thirty-four hotel properties had changed their scale from midscale (without food

1. For example, if a hotel changed its scale between October 2004 and September 2005, the effect of the change would be more accurately reflected in 2005, rather than 2004 annual performance. Therefore, performance at time $t + 1$ (a year after the change) would be financial performance of 2005, and performance at time t (before the change) would be 2004.
2. The significant correlations between "number of rooms," "marketing expenses," and financial performance variables motivated us to include "number of rooms" and "marketing expenses" in our regression models discussed later in this article.

Exhibit 3:
Summary Statistics and Correlations (as of 2005)

	NOI	*ADR*	*Occupancy*	*Rooms*	*Marketing Expenses*
Scale change (dummy)	N/A				
Net operating income (NOI)	1.000				
Average daily rate (ADR)	.630***	1.000			
Occupancy	.099	.004	1.000		
Rooms	.649***	.377***	–.140	1.000	
Marketing expenses	.878***	.629***	–.057	.816***	1.000
Mean	$1,461,277	$78.09	63.2%	189	$398,290
Median	$776,268	$67.39	63.5%	130	$13,519
SD	$2,165,003	$42.02	9.4%	158	$801,190
Min.	–$75,285	$31.57	34.8%	52	$226
Max.	$17,230,483	$250.82	86.5%	966	$5,072,491

***Significant at .01.

Exhibit 4:
Hotel Brand/Scale Changes

	Previous Scale							
Current Scale	*Luxury*	*Upper Upscale*	*Upscale*	*Midscale with F&B*	*Midscale without F&B*	*Economy*	*Independent*	*Total*
Luxury							2	2
Upper Upscale		4[a]	6	2				12
Upscale		4	2[a]	2			2	10
Midscale with food and beverage (F&B)			2	2[a]	1	5	1	11
Midscale without F&B			12		2[a]			14
Economy				1	34			35
Independent	1	1	1	1	5	2		11
Total	1	9	23	8	42	7	5	95

a. Denotes hotels that experienced brand changes only while maintaining their scales.

and beverage) to economy, and twelve hotels had dropped from upscale to midscale (also without food and beverage). Ten hotels changed only their brands without changing their scales. Fifteen hotels moved upward in scale, while eleven hotels terminated their brand and became independents (see Exhibit 4).

Scale Change Matters

We first explored the effect of changing brand or scale on net operating income,

Exhibit 5:
Average Net Operating Income (NOI), Average Daily Rate (ADR), and Average Occupancy Rate for Subject Hotel Properties

Year	t	t + *1*	t + *2*
NOI	$2,517,756	$1,633,109	$3,279,342
ADR	$109.12	$114.20	$124.96
Occupancy rate	56.3%	57.3%	62.0%
Rooms = 189			
Age = 19 years			

Note: *t* = before rebranding/rescaling; *t* + 1 = year immediately following the change; *t* + 2 = two years after the change.

and then considered the effects of brand or scale change ADR, occupancy, and RevPAR. As shown in Exhibit 5, a hotel's overall financial performance was enhanced in the second year following the change of brand or scale (*t* + 2), but in the first year after the change (*t* + 1) NOI actually declined. ADR and occupancy rate gradually increased after rebranding or rescaling, and the magnitude of the increase became larger two years after the change, as reflected in the NOI figures.

Despite the observed changes in financial ratios, we are not able to conclude that rebranding or rescaling drove those changes until we test whether the changes in NOI, ADR, and occupancy rate are partially or completely attributable to market conditions. To test this, we compared the performance trends of rebranded and rescaled hotels to those of randomly selected hotels that did not change brand or scale during the same time period (which we call "unchanged hotels").

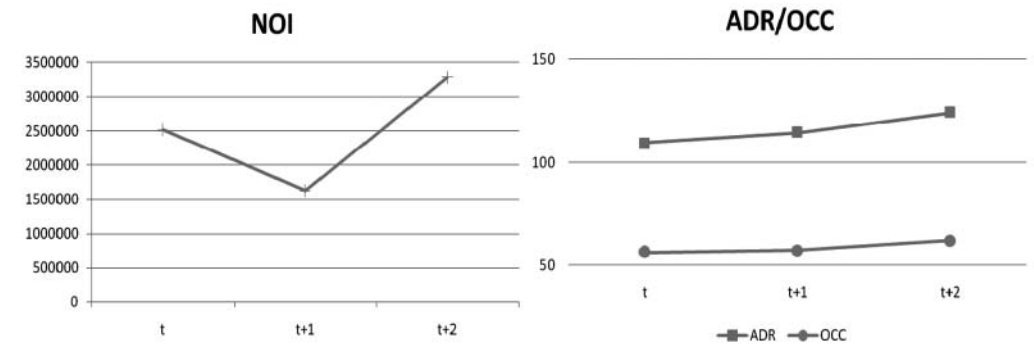
We took a random sample of ninety-five unchanged hotels, with the following limitation: we matched the number of hotels for each scale in the unchanged set to that of the changed groups. The ninety-five unchanged hotels had 215 rooms on average and their mean age was twenty-one years old, not significantly different from those of the ninety-five rescaled hotels.[3]

In contrast to the V-shaped change in NOI for the changed hotels (Exhibit 6), the unchanged hotels exhibited a steady increase in NOI over the three years studied (Exhibit 7). Despite favorable market conditions during the study period, rebranded or rescaled hotels experienced a decline in NOI immediately after the scale change. Thus, we can confirm that rebranding or rescaling substantially drove the hotel's NOI.

Rebranding or rescaling can involve investment in renovations (particularly when a hotel is undergoing an upward change), additional employee training, and marketing expenses. Consequently, we conclude that the hotel's NOI will be reduced in the first year probably due to these expenses. Our study indicates that the hotel's NOI appears to recover in the second year following the change (at least, with favorable market conditions). This lag effect implies that the effect of rebranding or rescaling is long-run NOI

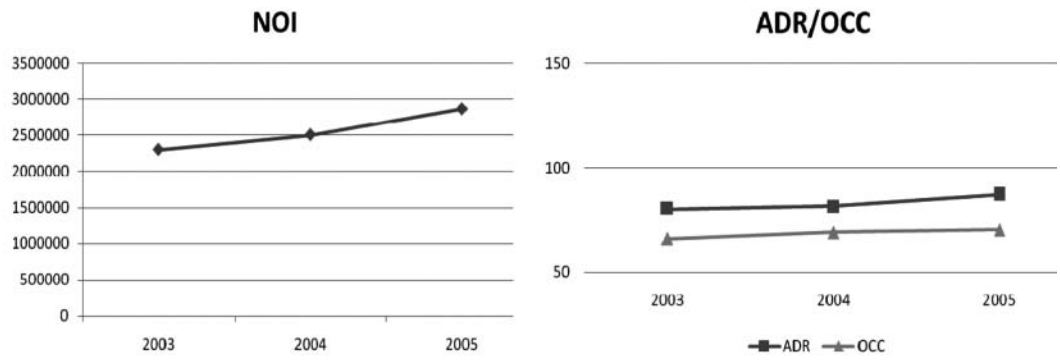
3. *P*-value of independent *t*-test to compare mean number of rooms between the two groups was .357; *p*-value of independent *t*-test to compare mean age between the two groups was .409.

Exhibit 6:
Hotel Performance Trends after a Scale/Brand Change



Note: NOI = net operating income; ADR = average daily rate; OCC = occupancy rate; *t* refers to the time when a hotel changed its scale; *t* + 1 demotes one year after; and *t* + 2 is two years after rebranding/rescaling.

Exhibit 7:
Performance Trends for No-Brand/Scale-Change Hotel Properties



Note: NOI = net operating income; ADR = average daily rate; OCC = occupancy rate.

improvement. (This assumes that the change was appropriate for the market and that the operator is able to manage the short-term decline immediately following the change.) Again, the analysis is based on results that occurred during a period of favorable economic and lodging industry trends. The comparison of performance trends indicated a uniformly positive trend in the ADR market indicator regardless of hotel brand or scale change status.

Which Scale?

Univariate analysis of covariance (ANCOVA) results revealed a significant difference in mean performance change

(except for occupancy change) among the hotels that changed scales according to their new scale.[4] We conducted a regression analysis among rescaled hotels to see whether a change upward to a certain scale resulted in a significantly better (or worse) performance than did a change downward.

We divided the ninety-five rebranded and rescaled hotels into the following three groups: (1) hotels that changed from relatively higher to relatively lower scales (sixty-four hotels), (2) hotels that changed from relatively lower to relatively higher scales (twenty-one hotels), and (3) hotels that changed only their brands without scale changes (ten hotels).[5] Two multiple regression analyses were conducted to examine how different types of brand and scale changes influence hotel performance. In the first regression, we treated the brand-only changers as a reference group and tested for downward movement and upward movement. Then in the second regression we treated the scale changers as a reference group and tested for changes in brand only. In the process, we controlled for factors that might have influence on hotel performance, such as size and marketing expenses.

Our analysis found that hotels that moved up in the chain scale achieved a higher ADR (as shown in Exhibit 8). However, only ADR was significantly influenced by rescaling from lower to higher scales. On the other hand, hotels that moved from higher to lower scales saw no significant change in ADR. We believe that this effect occurred because more than half of the hotels in the high-to-low group (thirty-four of sixty-four hotels) changed their scales from midscale to economy, and they were able to maintain their ADR even after the change. Rebranding without rescaling had no significant effect on any of the financial performance indicators, as shown in Exhibit 9. As expected, hotel size (rooms) and marketing expenses had significant associations with NOI in both regression analyses.

Conclusions

Many studies have examined the power of branding (for example, W. G. Kim and Kim 2004; Dube, Le Bel, and Sears 2003; Olsen et al. 2005), but our exploratory study showed little difference in financial or market ratios for the ten hotels that were rebranded without changing their market scale. Our sample is admittedly small, but it may be that individual hotel attributes (for example, location or facilities) are more important than brand for performance when a hotel is merely rebranded. In addition, some consumers may not perceive fine distinctions among hotel brands. The analysis of hotel performance trends after rebranding or rescaling revealed a temporary decline in hotel NOI immediately following the change, probably reflecting the inherent costs of making a change. Our results further suggest that a scale change from low to high may have a positive effect on ADR, while the move upscale has limited effect on NOI and occupancy rate.

We used what we believe to be the best available data for this study, but as we

4. Net operating income (NOI): $F = 5.434$, $p = .000$; average daily rate (ADR): $F = 6.257$, $p = .000$; occupancy rate (OCC): $F = 2.045$, $p = 0.77$; revenue per available room (RevPAR): $F = 6.487$, $p = .000$.
5. The three scale change groups were dummy-coded. We created three dummy variables:
   1. *high-to-low:* 1 if a hotel changed from high scale to low scale (e.g., luxury to economy), 0 otherwise;
   2. *low-to-high:* 1 if a hotel changed its scale from low to high (e.g., economy to luxury), 0 otherwise; and
   3. *brand only:* 1 if a hotel changed its brand only while maintaining its scale.

Exhibit 8:
Regression Analysis—High to Low, Low to High Scale Changes

Variable	*Standardized Beta*	t-*Value*
Model 1: Net operating income (NOI) change as a dependent variable		
High to low	259,999	0.650
Low to high	288,608	0.631
Rooms	–3,366	–3.828***
Marketing expenses	4	11.979***
F(4, 90) = 57.837***		
Model 2: Average daily rate (ADR) change as a dependent variable		
High to low	–4.01	–1.32
Low to high	7.48	2.152**
Rooms	0.005	0.758
Marketing expenses	0.000	0.388
F(4, 90) = 8.822***		
Model 3: Occupancy change as a dependent variable		
High to low	5.13	1.497
Low to high	7.84	1.967*
Rooms	–0.010	–1.317
Marketing expenses	0.000	–1.686
F(4, 90) = 2.510**		

*Significant at .10. **Significant at .05. ***Significant at .01.

explained above, the database of 1,960 hotels yielded a relatively small usable sample of 95 hotel properties. Sample size may have had an effect on levels of statistical significance. Also, as previously discussed, our results suggest that the positive effects of brand and scale changes may continue beyond a three-year window, at least in an expanding economy. We hope that these findings encourage additional research, specifically for a larger sample, over longer and different time periods (for example, during a contracting economy), and collecting data regarding capital and operational expenses as well.

The scope of this exploratory research did not include motivation for the change in brand or scale or due diligence and analytical processes, but it appears that, as stated earlier, changes in tastes and preferences, competition, new concepts, and changing brand standards provide situations that make it appropriate for some hotels to change brand or scale and achieve more favorable results.

It is interesting to note the substantial number of hotels that moved downscale even during an expanding economy when relatively upscale hotels were performing strongly. As stated earlier, changes can be especially important if a lodging product or its services become less efficient. Approximately two-thirds of the hotels in our sample changed from a higher to lower scale, likely responding to age and new supply and competition. For hotels in this sample, this strategy appears to have been largely an effective one.

Exhibit 9:
Regression Analysis—Brand Change Only

Variable	*Standardized Beta*	t-*Value*
Model 1: Net operating income (NOI) change as a dependent variable		
Brand only	–1,267,022	–0.693
Rooms	–3,327	–4.423***
Marketing expenses	4	12.813***
F(3, 91) = 77.964***		
Model 2: Average daily rate (ADR) change as a dependent variable		
Brand only	0.77	0.245
Rooms	0.020	3.232***
Marketing expenses	0.000	1.831*
F(3, 91) = 4.078***		
Model 3: Occupancy change as a dependent variable		
Brand only	–5.62	–1.652
Rooms	–0.004	–0.583
Marketing expenses	0.000	1.213
F(3, 91) = 2.510**		

*Significant at .10. **Significant at .05. ***Significant at .01.

The costs of renovating to meet a new brand's standards and training and marketing expenditures are obvious expenses of a change of brand or scale, but this research revealed a frequent short-term decline in NOI that may reflect other factors or higher costs than might be anticipated. Based on this finding, executives planning scale or brand changes should anticipate possible short-term declines in profitability (typically, one year). Because this research was exploratory, and this finding was not anticipated, we can only speculate about the decline in NOI. Based on our experience, we offer the following as implications for future research:

> Is there an initial loss of operational efficiencies following a brand or scale change as new systems are installed and implemented and employees become familiar with the new systems, procedures, and standards?
>
> What are the actual accounting treatments for renovations, marketing, and training? What other expenses are affected? How effective is budgeting for a brand or scale change?

One other finding was that ADR did not decline substantially with a change to a lower scale, especially for hotels moving from midscale to economy concepts. We believe this finding is a most instructive one. It may indicate the importance of hotels' specific attributes over brand or scale and may provide guidance that favors conversion to a lower brand or scale than one might originally expect. A favorable finding is that ADR is significantly and positively affected by a change to a higher scale. This finding combined with the prior

one suggests there may be limited "downside" to ADR for conversions "down," but there may be positive "upside" to ADR for conversions "up."

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