teaching note

Abstract

This case study identifies possible reasons that prompted Hilton Worldwide, Inc. to terminate their eight-year long franchise agreement with the Las Vegas Hilton, Hilton's second largest property. Hilton's principles of franchising are analyzed and compared against the most recent financials and feedback on customer satisfaction at the Las Vegas Hilton. The study shows that the most likely reason for the franchise agreement termination was due to compromised service quality. A strong argument is made that the fall of the Las Vegas Hilton was a result of real estate market volatility and Hilton's assets disposition program from 2004 to 2006.

Teaching Objectives and Strategy

This case study can be used primarily for a franchising course. The objectives based on the content that can be further explored are listed below:

1. Principles of franchising
2. Franchisor-Franchisee relationships and conditions that can lead to termination of a franchise agreement
3. Franchisee obligations in protecting brand image and brand equity
4. Impact of a franchisor's long-term decisions on success of a franchise system.

This case study is based on recent events and should be effective in starting an active discussion. The level of involvement will depend on the type of audience. The case study is appropriate for undergraduate as well as graduate studies. Below are examples of discussion points and connection to the theories:

1. Principles of franchising: Hilton's principles of franchising can be applied to the majority of franchise chains. The Hilton franchise strategy arguably rests on three core principles that are in place to ensure the greatest possible success for both the franchisor and the franchisee.

a. First, Hilton is centrally focused on preserving and maintaining their particular brand and associated brand image. Vital to achieving this goal is the proper assessment of the product that Hilton offers its customers. Moreover, Hilton adheres to the view that a brand's image is only as strong as its weakest property. Thus, each of Hilton's properties – whether they are franchisee-run or not – must uphold the high standards of the Hilton brand. Aside from maintaining the brand, Hilton also seeks to improve on their brand continually in order to keep abreast of its competitors.

b. Second, Hilton seeks to build new brands in new markets whenever it is judged to be financially advantageous, thus Hilton's franchisees are encouraged to develop new brands.

c. Third, customer loyalty is of paramount importance to the Hilton franchise. Franchisees are instructed to build customer loyalty through superior service quality and a high-quality product.

In order to achieve these goals, Hilton emphasizes open and regular communication between the franchisees and the franchisor. In particular, Hilton asks its franchisees to communicate to Hilton how it can help the franchisee and how it should best proceed to benefit the brand and maintain a positive franchisor-franchisee relationship.

2. Franchisor-Franchisee relationship: The study provides an example of an unsuccessful franchise relationship due to franchisee's inability to fully comply with franchisor's requirements.

In order to create and maintain a beneficial and smoothly running franchise relationship, the franchisor and the franchisee must make a commitment to open and regular communication. The franchisor is responsible for clearly outlining the standards and requirements of the relationship with the franchisee and the franchisee in turn is responsible for making sure all aspects of the formal franchise relationship are understood and requirements are properly followed. In the case of the Hilton Las Vegas franchise relationship, it is difficult to determine whether problems with communication lay at the root of the unsuccessful franchise relationship. This problem is further exasperated by the fact that Hilton offered no comment on the relationships between Hilton and its franchisees. However, it appears most likely that the relationship became unsuccessful primarily as a result of financial difficulties that led to deterioration of the hotel. As the case study discusses, the franchisee appears to have entered into the franchise relationship with Hilton at a financially inopportune time and foresaw neither the financial consequences that the then-current real estate market might entail nor the financial demands of the Hilton franchise relationship.

3. Franchisee's obligation in preserving brand image: Franchisors should hold individual franchisees responsible for maintaining a consistent brand image and adhering to the principal that a chain is only as strong as its weakest link.

The franchisor's main goal is to maintain their product's standards of service and quality, and ultimately to sustain the brand itself. Consequently, the franchisee is central to achieving this goal, for the franchisee carries out the operations that eventually become the services and products advertised by the franchisor. In the case of Hilton Hotels and its franchise relationships, it is important to note that their adherence to the principle that a chain is only as strong as its weakest links binds it to making sure that all of its franchisees are delivering services and products of similar quality. If one of its franchisees is lagging behind and not delivering the proper level of service quality, the whole chain may be compromised. This possibility is perhaps even more powerful in the current age as a direct result of the Internet and social media. With the help of social media, people can access and promulgate any possible review or comment related to any service or product. Therefore, negative reviews of one link in the chain may overwhelm and override the positives and thus compromise the franchisor's entire brand.

4. Effect of a franchisor's long-term strategy on success of its franchisees: The question is raised on whether a failure of a franchisee can be traced back to a strategic or financial decision made by the franchisor.

Though it is difficult to quantify the actual relationship of the franchisor (Hilton Worldwide) to its franchisee (the Las Vegas Hilton), it is nonetheless possible to generalize about the effects of Hilton's long-term franchise strategy on the franchisee in question and its franchisees overall. As noted by the case study, Hilton adopted a strategy of selling many of its prime hotel properties between 2004 and 2006. Although this was a highly profitable move for the Hilton Hotel Corporation at the time, it is likely that the long-term effects of such a strategy and the franchise relationships that ensued brought on more losses than gains. In a successful franchisor-franchisee relationship, the franchisor must properly evaluate the short-term as long as the long-term consequences of its strategy. A strategy that appears profitable for the franchise in the short-term may ultimately be harmful in the long term and lead to unnecessary losses. Once again, the Las Vegas Hilton franchisee exhibits such a possibility.

Teaching Approaches

This case study provides multiple possibilities to be used as a teaching tool for those wishing to learn about franchisor-franchisee relationships.

1. The study may be assigned as supplementary reading for the class, as well as an example (in the form of short essay question) on a class assessment, such as an examination or quiz.
2. The case study may be used for a debate exercise. The class may be split into two and asked to consider one of the discussion questions. One group could represent the franchisor and the other may represent the franchisee. Each half of the class should prepare reasons and evidence to support their side of the argument regarding the assigned discussion question.
3. Because the reasons for the unsuccessful franchise relationship between Hilton Worldwide (franchisor) and the Las Vegas Hilton (franchisee) are difficult to pinpoint exactly, the case study may be used as a research catalyst. Students could be asked to further investigate/research the franchisor-franchisee relationship and come up with reasons for its ultimate failure and termination.
4. The case study may be given as an assignment for which the students are asked to discuss the merits of the actions taken by franchisors and franchisees and how these actions positively or negatively impact the franchisor-franchisee relationship.

Discussion Questions

1. Based on the available data and customer reviews, was Hilton's decision to terminate the Las Vegas Hilton franchise agreement justified? Why or why not?
2. Was there anything that Hilton as a franchisor should or could have done to save its ailing Las Vegas Hilton franchise?
3. What are the benefits and drawbacks of a franchise unit ownership change?
4. To what extent does an individual franchisee's performance affect the franchise system as a whole?
5. Discuss possible impacts Hilton's 2004-2006 year asset disposition program may have on the future of Hilton franchising.

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