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An Investigation of Asset Expenditure Management in Australian Hotels

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ABSTRACT

Australian hotels compete with hotels in other countries in the international tourism market and must therefore be in good physical condition to meet international and domestic traveller expectations. This highlights the importance of hotels maintaining a continuing vigilance with respect to ensuring asset related expenditure decision making is appropriately conducted. Such decisions are, however, complex due to their high dollar value as well as their cyclical, ambiguous and frequently irreversible nature. The broad aim of this research is to further understanding of factors relating to asset expenditure management practices in Australian hotels, a topic that has drawn little prior research attention.

The thesis has drawn extensively on theories of agency theory and organisational power. The study adopted a mixed methods approach utilising two empirical phases. The first phase involved a series of face-to-face interviews with six different stakeholder groups representing asset managers, hotel lawyers, hotel auditors, hotel owners, hotel general managers, and hotel financial controllers. A total of twenty interviews were conducted. The second phase involved the administration of a questionnaire survey to general managers of Australian and New Zealand hotels with twenty or more rooms and a star-rating of three or more.

Major findings arising from the interview phase include the following:

1. Australian hotel owners currently hold the balance of power with respect to contracting with hotel operators. The power balance appears to be around 60:40 in favour of owners.
2. Factors affecting the locus of power between hotel owners and operators include: (1) size of hotel owner; (2) size of hotel operator; (3) location of hotel; (4) strength of operator’s brand; (5) composition of operator’s management team; (6) credibility and reputation of owner and operator; and (7) size and condition of the hotel.
3. Annual allocations to the furniture, fittings and equipment (FF&E) reserve in Australian hotels operating under a management contract tend to be underfunded by approximately two per cent of gross revenue.
4. Identification of seven causal factors of FF&E reserve under-funding.
5. Increased use of brand standard clauses in management contracts are resulting in increased owner FF&E reserve expenditure assigned to projects that uphold brand standards that are frequently inconsistent with owner’s preferred spending.
6. Regardless of the size of a capital budgeting project, a mixture of quantitative and qualitative capital budgeting appraisal techniques appear to both be applied in the decision-making process.
7. Hotel owners’ concern over the difficulty of formulating accurate cash flow estimates when applying quantitative investment appraisal techniques results in the application of qualitative investment appraisal techniques in the decision making process.
8. Operators are inclined to positively bias capital budgeting proposals toward projects that protect their brand, provide a consistent customer experience and raise management fees. Owners attach greater importance to the achievement of bottom-line profitability, which may be undermined by operators’ positively biasing capital budgeting proposals.
9. Despite differing objectives of long-term and short-term focused hotel owners, the overriding factor determining the strategic focus and timing of capital expenditure appears to be the extent to which the market rewards an owner’s investment strategy.

Some of the statistically significant findings of the questionnaire survey phase of the study include the following:

1. As hotel size increases, hotel management contracts become longer ($p < .05$; two-tailed test).
2. As hotel size increases, there is a decrease in the use of the cash funded FF&E reserve accounting approach ($p < .1$; two-tailed test).
3. As hotel size decreases, hotel owners have a greater propensity to release FF&E reserve funds ($p = < .1$; two-tailed test).
4. Greater hotel owner involvement in the capital budgeting process is positively related to the application of sophisticated quantitative capital budgeting techniques ($p < .1$; one-tailed test).
5. Relative to hotels operating without management contracts, hotels with management contracts use sophisticated quantitative capital budgeting techniques to a low degree ($p < .05$; two-tailed test).
6. Greater hotel owner involvement in the capital budgeting process leads to greater use of qualitative capital investment appraisal techniques ($p < .05$; one-tailed test).
7. Large hotels make greater use of quantitative techniques in investment appraisal ($p < .01$; one-tailed test).
8. The shorter the time to expiry of a management contract, the greater the propensity of hotel management to positively bias capital budgeting proposals ($p < .05$; one-tailed test).
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abstract</td>
<td>iii</td>
</tr>
<tr>
<td>Table of contents</td>
<td>v</td>
</tr>
<tr>
<td>List of tables</td>
<td>xii</td>
</tr>
<tr>
<td>List of figures</td>
<td>xix</td>
</tr>
<tr>
<td>List of appendices</td>
<td>xx</td>
</tr>
<tr>
<td>Statement of originality</td>
<td>xxi</td>
</tr>
<tr>
<td>Acknowledgement</td>
<td>xxii</td>
</tr>
</tbody>
</table>

## CHAPTER 1: INTRODUCTION

1.1 Introduction                                                      | 1    |
1.2 Motivation                                                        | 1    |
1.3 Research objectives                                               | 4    |
1.4 Background                                                        | 5    |
1.5 Thesis structure                                                  | 6    |
1.6 Conclusion                                                        | 9    |

## CHAPTER 2: THE AGENCY THEORY AND ORGANISATIONAL POWER LITERATURES

2.1 Introduction                                                      | 10   |
2.2 The agency theory literature                                      | 10   |
2.3 The organisational power literature                                | 15   |
2.4 Conclusion                                                        | 18   |

## CHAPTER 3: HOTEL OPERATIONAL STRUCTURES

3.1 Introduction                                                      | 20   |
3.2 Hotel operational structures                                      | 20   |
  3.2.1 Owner-operator                                                 | 20   |
  3.2.2 Franchise                                                      | 21   |
  3.2.3 Management contract                                            | 23   |
3.3 Conclusion                                                        | 27   |

## CHAPTER 4: THE HOTEL MANAGEMENT CONTRACT STAKEHOLDER NETWORK

4.1 Introduction                                                      | 29   |
4.2 The hotel management contract stakeholder network                  | 29   |
4.3 The relationship between the owner and operator                   | 33   |
4.4 The relationship between the general manager / financial controller and the operator and owner | 40   |
4.5 The relationship between the owner and asset manager              | 41   |
4.6 The role of bankers and lenders in the management contract stakeholder network | 42   |
4.7 Conclusion                                                        | 44   |
8.3.2.1 Validity in face-to-face interviews ........................................ 114
8.3.2.2 Validity in questionnaire surveys ........................................ 115
8.4 Conclusion .............................................................................. 116

CHAPTER 9: INTERVIEW FINDINGS

9.1 Introduction .............................................................................. 117
9.2 The interview sample ............................................................... 117
9.3 The interview schedule ............................................................. 122
9.4 Investigating the locus of power between hotel owners and operators (research objective one) .................................................. 123
9.5 Approaches to FF&E reserve accounting (research objective two) .......... 125
9.6 Owner and operator attitudes with respect to the sufficiency of funds allocated to the FF&E reserve account (research objective three) .......... 128
9.7 Owner and operator opinions with respect to problems surrounding the release of funds from the FF&E reserve account (research objective four) ................................................................. 133
9.8 Investigating the relative importance of quantitative investment appraisal in hotels (research objective six) .................................................. 136
9.9 Investigating the propensity of hotel management to positively bias capital budgeting proposals (research objective seven) ......................... 140
9.10 Impact of owner characteristics on strategic focus and timing of capital spending (research objective eight) .............................................. 144
9.11 Conclusion .............................................................................. 147

CHAPTER 10: PROPOSITION DEVELOPMENT

10.1 Introduction .............................................................................. 149
10.2 Proposition development .......................................................... 149
   10.2.1 Model 1: Length of hotel management contract .......................... 154
   10.2.2 Model 2: Choice of FF&E reserve accounting approach ............... 154
   10.2.3 Model 3: Adequacy of funds allocated to the FF&E reserve account .............................................................................. 155
   10.2.4 Model 4: Hotel owner propensity to release FF&E reserve account funds .............................................................................. 156
   10.2.5 Model 5: Sophisticated quantitative capital budgeting technique usage .............................................................................. 157
   10.2.6 Model 6: Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal .......... 161
   10.2.7 Model 7: Propensity of hotel management to positively bias capital budgeting proposals .............................................................................. 165
10.3 Conclusion .............................................................................. 169

CHAPTER 11: MEASURES AND QUESTIONNAIRE DESIGN

11.1 Introduction .............................................................................. 170
11.2 Questionnaire design ............................................................... 171
   11.2.1 General issues in questionnaire design ...................................... 171
11.3 Questionnaire piloting .............................................................. 172
11.4 Questionnaire measures .......................................................... 173
11.4.1 Section A – Hotel background information (questions 1 – 7) …… 176
  11.4.1.1 Star-rating of hotel (question 1) ................................. 176
  11.4.1.2 Ownership / management structure (question 2) ............ 176
  11.4.1.3 Age of hotel property (question 4a) ............................ 177
  11.4.1.4 Number of years the general manager has been in their current position .................................................. 177
  11.4.1.5 Public or private hotel ownership (question 5) .............. 177
  11.4.1.6 Size of hotel property (question 6) ............................. 178
  11.4.1.7 Size of hotel owner (question 7) ............................... 178

11.4.2 Section B – Factors affecting hotel capital budgeting proposals (questions 8 – 20) .................................................. 179
  11.4.2.1 Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal (questions 8 – 9) .............................................................. 179
  11.4.2.2 Propensity of hotel management to positively bias capital budgeting proposals (questions 10 – 12) ......................... 183
  11.4.2.3 Ego-trip ownership (questions 13 – 15) ....................... 185
  11.4.2.4 Hotel owner involvement in the preparation of capital budgeting proposals (questions 16 – 19) .......................... 186
  11.4.2.5 Emphasis attached to sophisticated quantitative capital budgeting techniques (question 20) ............................... 189

11.4.3 Section C – Issues arising from the use of hotel management contracts (questions 21 – 33) ........................................ 189
  11.4.3.1 Length of hotel management contract (question 21) ...... 189
  11.4.3.2 Remaining length of hotel management contract (question 22) ........................................................................ 189
  11.4.3.3 FF&E reserve accounting approach applied (question 23) ... 190
  11.4.3.4 Adequacy of funds allocated to the FF&E reserve account (questions 24 – 26) .......................................................... 190
  11.4.3.5 Hotel owner propensity to release FF&E reserve account funds (questions 27 – 29) ....................................................... 191
  11.4.3.6 Locus of power between hotel owner and hotel operator (questions 30 – 31) ............................................................... 191

11.5 Conclusion ........................................................................ 199

CHAPTER 12: QUESTIONNAIRE ADMINISTRATION, DATA SCREENING AND DESCRIPTIVE STATISTICS

12.1 Introduction ...................................................................... 200
12.2 Sampling procedures ........................................................ 200
12.3 Questionnaire data screening .............................................. 202
  12.3.1 Data input accuracy ...................................................... 202
  12.3.2 Out-of-range values ...................................................... 202
  12.3.3 Plausible means and standard deviations ..................... 203
  12.3.4 Univariate outliers ...................................................... 203
  12.3.5 Missing data ............................................................. 204
  12.3.6 Normality ................................................................. 205
12.4 Nonresponse bias investigation ........................................... 206
12.5 Descriptive statistics .......................................................... 211
  12.5.1 Star-rating (question 1) ................................................ 211
12.5.2 Hotel operating structure (question 2) .................................................. 212
12.5.3 Hotel age (question 4a) ........................................................................ 213
12.5.4 Years GM (question 4b) ........................................................................ 213
12.5.5 Public vs. private hotel ownership (question 5) .................................... 213
12.5.6 Hotel size in number of rooms (question 6a) ........................................ 214
12.5.7 Hotel size in AUD$ turnover (question 6b) ............................................. 214
12.5.8 Hotel owner size in number of hotel properties owned (question 7a) .................. 215
12.5.9 Hotel owner size in terms of number of hotel rooms owned (question 7b) .................. 215
12.5.10 Factors influencing whether an investment proposal approved (question 8) .................................................. 216
  12.5.10.1 Financial analysis (questions 8a, 8j, 8l) ........................................ 216
  12.5.10.2 Strategic analysis (questions 8b, 8c, 8i) ........................................ 217
  12.5.10.3 Internal political factors (questions 8e, 8g, 8h) .......................... 218
  12.5.10.4 Managerial intuition (questions 8d, 8f, 8k) .................................. 219
12.5.11 Importance of quantitative vs. qualitative analysis in appraising investment proposals (question 9) .................................................. 220
12.5.12 Propensity to bias capital budgeting proposals (questions 10, 11 and 12) .................................................. 221
12.5.13 Ego-trip hotel ownership (question 13, 14, 15) ................................. 222
12.5.14 Owner involvement in the capital budgeting process (questions 16, 17, 18, 19) .................................................. 223
12.5.15 Use of four common capital budgeting appraisal techniques (question 20) .................................................. 225
12.5.16 Original length of management contract (question 21) ...................... 226
12.5.17 Number of years until management contract expires (question 22) .................................................. 227
12.5.18 Type of FF&E reserve (question 23) .................................................. 227
12.5.19 Percentage of gross revenue allocated annually (after ramping up to the FF&E reserve account (question 24) .................................................. 228
12.5.20 Sufficiency of funds allocated to the FF&E reserve (question 25) .................................................. 229
12.5.21 Percentage of gross revenue required to cover the true cost of reasonable annual FF&E expenditure (question 26) .................................................. 229
12.5.22 Release of funds from the FF&E reserve (questions 27, 28, 29) .................................................. 229
12.5.23 Evaluation of the locus of power between hotel owner and hotel operator (question 30) .................................................. 230
  12.5.23.1 Reward power (questions 30a, 30f, 30k) ................................ 231
  12.5.23.2 Coercive power (questions 30b, 30g, 30l) ................................ 232
  12.5.23.3 Legitimate power (questions 30c, 30h, 30m) ............................ 233
  12.5.23.4 Expert power (questions 30d, 30i, 30n) .................................. 234
  12.5.23.5 Referent power (questions 30e, 30j, 30o) .............................. 235
12.5.24 Holistic power (question 31) .................................................. 236
12.6 Conclusion .................................................................................. 237

CHAPTER 13: DESCRIPTION OF KEY VARIABLES

13.1 Introduction .................................................................................. 238
13.2 Assessment of the suitability of the data set for factor analysis .................................................................................. 238
13.3 Variable measurement ................................................................. 238
  13.3.1 Variable 1: Hotel size (question 6) ........................................ 239
  13.3.2 Variable 2: Hotel owner size (question 7) ............................ 239
  13.3.3 Variable 3: Factors influencing investment proposal acceptability (question 8) ................................................................. 239
  13.3.4 Variable 4: propensity of hotel management to positively bias capital budgeting proposals (questions 10 – 12) ....................... 244
  13.3.5 Variable 5: Ego-trip ownership (questions 13 – 15) ................ 246
  13.3.6 Variable 6: Hotel owner involvement in the preparation of capital budgeting proposals (questions 16 - 19) ............................ 246
  13.3.7 Variable 7: Emphasis attached to sophisticated quantitative capital budgeting techniques (question 20) ................................. 248
  13.3.8 Variable 8: Adequacy of funds allocated to the FF&E reserve account (questions 24 – 26) .............................................................. 250
  13.3.9 Variable 9: Hotel owner propensity to release FF&E reserve account funds (questions 27 – 29) .............................................................. 250
  13.3.10 Variable 10: Locus of power between hotel owner and hotel operator (question 30) ................................................................. 252
    13.3.10.1 Reward power (questions 30a, 30f, 30k) ......................... 252
    13.3.10.2 Coercive power (questions 30b, 30g, 30l) ..................... 254
    13.3.10.3 Legitimate power (questions 30c, 30h, 30m) ................. 255
    13.3.10.4 Expert power (questions 30d, 30i, 30n) ...................... 257
    13.3.10.5 Referent power (questions 30e, 30j, 30o) ................... 259
  13.3.11 Degree of association between bases of power and holistic locus of power question (question 31) ......................................................... 260
13.4 Conclusion .............................................................................. 261

CHAPTER 14: STATISTICAL ANALYSIS AND PROPOSITION TESTING

14.1 Introduction ............................................................................. 262
14.2 Underlying assumptions of regression analysis ...................... 262
  14.2.1 Multicollinearity ................................................................. 262
  14.2.2 Multivariate outliers ............................................................ 263
  14.2.3 Linearity and homoscedasticity ........................................... 263
14.3 Regression findings model 1: Length of hotel management contract ......................... 264
14.4 Regression findings model 2: FF&E reserve accounting approach applied ... 266
14.5 Regression findings model 3: Adequacy of funds allocated to the FF&E reserve account ................................................................. 267
14.6 Regression findings model 4: Hotel owner propensity to release FF&E reserve account funds ............................................................. 269
14.7 Regression findings model 5: Sophisticated quantitative capital budgeting technique usage .................................................................. 270
  14.7.1 Model 5 regression findings using single item index of sophistication ................................................................. 271
  14.7.2 Model 5 regression findings using multiple item index of sophistication ................................................................. 274
14.8 Regression findings model 6: Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal .... 277
CHAPTER 15: DISCUSSION AND CONCLUSIONS

15.1 Introduction ................................................................. 291
15.2 Synthesis and discussion of main findings .......................... 291
  15.2.1 Objective 1: To investigate the locus of power between hotel owners and operators ................................................ 291
  15.2.2 Objective 2: To investigate the different approaches to FF&E reserve accounting in hotels ........................................... 293
  15.2.3 Objective 3: To advance understanding with respect to the sufficiency of funds allocated to the FF&E reserve account .......... 294
  15.2.4 Objective 4: To advance understanding with respect to problems surrounding the release of funds from the FF&E reserve account .......... 297
  15.2.5 Objective 5: To investigate the degree to which sophisticated capital budgeting techniques are applied in hotels ......................... 300
  15.2.6 Objective 6: To investigate the relative importance of quantitative investment appraisal techniques in hotels .................................... 301
  15.2.7 Objective 7: To investigate the propensity of hotel management to positively bias capital budgeting proposals .......................... 302
  15.2.8 Objective 8: To investigate whether hotel owner characteristics impact on the strategic focus and timing of capital spending ................ 303
15.3 Limitations of the study ................................................... 304
15.4 Implications of findings ................................................... 306
  15.4.1 Implications of findings on theory development ................... 306
  15.4.2 Implications of findings on practice ............................... 307
  15.4.3 Suggestions for further study ....................................... 308
15.5 Conclusion ..................................................................... 314
<table>
<thead>
<tr>
<th>Table</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>Overview of research objectives</td>
<td>4</td>
</tr>
<tr>
<td>3.1</td>
<td>Distribution of hotel ownership modal types across major regions of destination</td>
<td>23</td>
</tr>
<tr>
<td>3.2</td>
<td>Interests of owners and operators under hotel management contracts</td>
<td>26</td>
</tr>
<tr>
<td>3.3</td>
<td>Issues to consider in the negotiation of a hotel management contracts</td>
<td>27</td>
</tr>
<tr>
<td>4.1</td>
<td>Length of management contracts: Research findings and commentaries</td>
<td>36</td>
</tr>
<tr>
<td>5.1</td>
<td>Overview of four most commonly used quantitative capital budgeting appraisal techniques</td>
<td>49</td>
</tr>
<tr>
<td>5.2</td>
<td>Capital budgeting appraisal technique usage in the Asia Pacific region</td>
<td>50</td>
</tr>
<tr>
<td>6.1</td>
<td>Use of quantitative capital budgeting appraisal techniques in U.S. hotels between 1990 and 1999</td>
<td>64</td>
</tr>
<tr>
<td>6.2</td>
<td>Annual FF&amp;E expenditure by hotel class in the United States</td>
<td>72</td>
</tr>
<tr>
<td>6.3</td>
<td>Empirical research on FF&amp;E reserve allocations</td>
<td>74</td>
</tr>
<tr>
<td>7.1</td>
<td>Prior research into the calculation of hotel operator base management fees</td>
<td>86</td>
</tr>
<tr>
<td>7.2</td>
<td>Prior research into the calculation of hotel operator incentive management fees</td>
<td>89</td>
</tr>
<tr>
<td>7.3</td>
<td>Prior research into the incidence of options in operator fee determination</td>
<td>93</td>
</tr>
<tr>
<td>7.4</td>
<td>Management contract termination: Incidence and nature of operator performance thresholds</td>
<td>95</td>
</tr>
<tr>
<td>7.5</td>
<td>Incidence and nature of owner options to terminate management contract without a cause</td>
<td>98</td>
</tr>
<tr>
<td>7.6</td>
<td>Calculation of operator management fees: Comparison of traditional management fee basis with residual income fee basis</td>
<td>102</td>
</tr>
<tr>
<td>Section</td>
<td>Title</td>
<td>Page</td>
</tr>
<tr>
<td>---------</td>
<td>-----------------------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>8.1</td>
<td>Knowledge claims, strategies of inquiry and methods used in quantitative, qualitative and mixed methods research</td>
<td>108</td>
</tr>
<tr>
<td>9.1</td>
<td>Schedule of interviewees</td>
<td>120</td>
</tr>
<tr>
<td>11.1</td>
<td>Background of individuals who piloted the questionnaire</td>
<td>172</td>
</tr>
<tr>
<td>11.2</td>
<td>Overview of proposition variables and their measurement</td>
<td>174</td>
</tr>
<tr>
<td>11.3</td>
<td>Overview of questionnaire question 8 used to measure the emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques</td>
<td>181</td>
</tr>
<tr>
<td>11.4</td>
<td>Overview of questionnaire questions to measure the propensity of hotel management to positively bias capital budgeting proposals</td>
<td>184</td>
</tr>
<tr>
<td>11.5</td>
<td>Overview of questionnaire questions 14 to 19 used to measure hotel involvement in the preparation of capital budgeting proposals</td>
<td>188</td>
</tr>
<tr>
<td>11.6</td>
<td>Overview of items pertaining to questionnaire question 30 used to measure the locus of power between hotel owner and operator</td>
<td>197</td>
</tr>
<tr>
<td>12.1</td>
<td>Summary of survey replies</td>
<td>202</td>
</tr>
<tr>
<td>12.2</td>
<td>Star-rating of sample compared to the population (question 1)</td>
<td>208</td>
</tr>
<tr>
<td>12.3</td>
<td>Star-rating (question 1)</td>
<td>212</td>
</tr>
<tr>
<td>12.4</td>
<td>Hotel ownership / management structure (question 2)</td>
<td>212</td>
</tr>
<tr>
<td>12.5</td>
<td>Hotel age (question 4a)</td>
<td>213</td>
</tr>
<tr>
<td>12.6</td>
<td>Years GM (question 4b)</td>
<td>213</td>
</tr>
<tr>
<td>12.7</td>
<td>Hotel owner’s entity (question 5)</td>
<td>214</td>
</tr>
<tr>
<td>12.8</td>
<td>Hotel size in number of rooms (question 6a)</td>
<td>214</td>
</tr>
<tr>
<td>12.9</td>
<td>Hotel size in annual sales turnover AUD$ (question 6b)</td>
<td>215</td>
</tr>
<tr>
<td>12.10</td>
<td>Hotel owner size in number of hotel properties owned (question 7a)</td>
<td>215</td>
</tr>
<tr>
<td>12.11</td>
<td>Hotel owner size in number of hotel rooms owned (question 7b)</td>
<td>215</td>
</tr>
<tr>
<td>12.12</td>
<td>Financial analysis (questions 8a, 8j, 8l)</td>
<td>217</td>
</tr>
<tr>
<td>12.13</td>
<td>Strategic analysis (questions 8b, 8c, 8i)</td>
<td>218</td>
</tr>
<tr>
<td>12.14</td>
<td>Internal political factors (questions 8e, 8g, 8h)</td>
<td>219</td>
</tr>
<tr>
<td>Section</td>
<td>Topic</td>
<td>Page</td>
</tr>
<tr>
<td>---------</td>
<td>----------------------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>12.15</td>
<td>Managerial intuition (questions 8d, 8f, 8k)</td>
<td>220</td>
</tr>
<tr>
<td>12.16</td>
<td>Importance of quantitative vs. qualitative analysis in appraising</td>
<td>221</td>
</tr>
<tr>
<td></td>
<td>investment proposals (question 9)</td>
<td></td>
</tr>
<tr>
<td>12.17</td>
<td>Propensity to bias capital budgeting proposals (questions 10, 11, 12)</td>
<td>222</td>
</tr>
<tr>
<td>12.18</td>
<td>Ego-trip ownership (questions 13, 14, 15)</td>
<td>223</td>
</tr>
<tr>
<td>12.19</td>
<td>Owner involvement in the capital budgeting process (questions 16,</td>
<td>225</td>
</tr>
<tr>
<td></td>
<td>17, 18, 19)</td>
<td></td>
</tr>
<tr>
<td>12.20</td>
<td>Use of four common capital budgeting appraisal techniques (question</td>
<td>226</td>
</tr>
<tr>
<td></td>
<td>20)</td>
<td></td>
</tr>
<tr>
<td>12.21</td>
<td>Original length of management contract (question 21)</td>
<td>226</td>
</tr>
<tr>
<td>12.22</td>
<td>Number of years until management contract expires (question 22)</td>
<td>227</td>
</tr>
<tr>
<td>12.23</td>
<td>Type of FF&amp;E reserve (question 23)</td>
<td>227</td>
</tr>
<tr>
<td>12.24</td>
<td>Percentage of gross revenue allocated annually (after ramping up)</td>
<td>228</td>
</tr>
<tr>
<td></td>
<td>to the FF&amp;E reserve account (question 24)</td>
<td></td>
</tr>
<tr>
<td>12.25</td>
<td>Sufficiency of funds allocated to the FF&amp;E reserve (question 25)</td>
<td>228</td>
</tr>
<tr>
<td>12.26</td>
<td>Percentage of gross revenue required to cover the true cost of</td>
<td>229</td>
</tr>
<tr>
<td></td>
<td>reasonable annual FF&amp;E expenditure (question 26)</td>
<td></td>
</tr>
<tr>
<td>12.27</td>
<td>Release of funds from the FF&amp;E reserve (questions 27, 28, 29)</td>
<td>230</td>
</tr>
<tr>
<td>12.28</td>
<td>Reward power (questions 30a, 30f, 30k)</td>
<td>232</td>
</tr>
<tr>
<td>12.29</td>
<td>Coercive power (questions 30b, 30g, 30l)</td>
<td>233</td>
</tr>
<tr>
<td>12.30</td>
<td>Legitimate power (questions 30c, 30h, 30m)</td>
<td>234</td>
</tr>
<tr>
<td>12.31</td>
<td>Expert power (questions 30d, 30i, 30n)</td>
<td>235</td>
</tr>
<tr>
<td>12.32</td>
<td>Referent power (questions 30e, 30j, 30o)</td>
<td>236</td>
</tr>
<tr>
<td>12.33</td>
<td>Holistic power (question 31)</td>
<td>237</td>
</tr>
<tr>
<td>13.1</td>
<td>Correlations for ‘factors influencing capital investment proposal</td>
<td>240</td>
</tr>
<tr>
<td></td>
<td>acceptability’ (question 8)</td>
<td></td>
</tr>
<tr>
<td>13.2</td>
<td>Communalities for ‘factors influencing capital investment proposal</td>
<td>241</td>
</tr>
<tr>
<td></td>
<td>acceptability’ (question 8)</td>
<td></td>
</tr>
</tbody>
</table>
13.3 Total variance explained for ‘factors influencing capital investment proposal acceptability’ (question 8) ........................................................ 241
13.4 Pattern matrix for ‘factors influencing capital investment proposal acceptability’ (question 8) .................................................................. 242
13.5 Correlations for ‘propensity of hotel management to positively bias capital budgeting proposals’ (questions 10 – 12) ........................................ 244
13.6 Communalities for ‘propensity of hotel management to positively bias capital budgeting proposals’ (questions 10 – 12) ........................................... 245
13.7 Total variance explained for ‘propensity of hotel management to positively bias capital budgeting proposals’ (questions 10 – 12) ...................... 245
13.8 Component matrix for ‘propensity of hotel management to positively bias capital budgeting proposals’ (questions 10 – 12) ........................................ 245
13.9 Correlations for ‘ego-trip ownership’ (questions 13 – 15) ................. 246
13.10 Correlations for ‘hotel owner involvement in the preparation of capital budgeting proposals’ (questions 16 - 19) ........................... 247
13.11 Communalities for ‘hotel owner involvement in the preparation of capital budgeting proposals’ (questions 16 - 19) ................................. 247
13.12 Total variance explained for ‘hotel owner involvement in the preparation of capital budgeting proposals’ (questions 16, 18, 19) ..... 248
13.13 Pattern matrix for ‘hotel owner involvement in the preparation of capital budgeting proposals’ (questions 16, 18, 19) ................................. 248
13.14 Relative usage of sophisticated vs. simple capital investment appraisal techniques .............................................................. 249
13.15 Correlations for ‘hotel owner propensity to release FF&E reserve account funds’ (questions 27 – 29) ................................................................. 251
13.16 Communalities for ‘hotel owner propensity to release FF&E reserve account funds’ (questions 27 – 29) ............................................................. 251
13.17 Total variance explained for ‘hotel owner propensity to release FF&E reserve account funds’ (questions 27 – 29) ........................................ 251
13.18 Component matrix for ‘hotel owner propensity to release FF&E reserve account funds’ (questions 27 – 29) ...................................................... 252
13.19 Correlations for ‘reward power’ (questions 30a, 30f, 30k) ............... 253
13.20 Communalities for ‘reward power’ (questions 30a, 30f, 30k) ............ 253
13.21 Total variance explained for ‘reward power’ (questions 30a, 30f, 30k) ................................................................. 253
13.22 Component matrix for ‘reward power’ (questions 30a, 30f, 30k) ...... 254
13.23 Correlations for ‘coercive power’ (questions 30b, 30g, 30l) ......... 254
13.24 Communalities for ‘coercive power’ (questions 30b, 30g, 30l) ...... 254
13.25 Total variance explained for ‘coercive power’ (questions 30b, 30g, 30l) ........................................................................... 255
13.26 Component matrix for ‘coercive power’ (questions 30b, 30g, 30l) ....255
13.27 Correlations for ‘legitimate power’ (questions 30c, 30h, 30m) ......... 256
13.28 Communalities for ‘legitimate power’ (questions 30c, 30h, 30m) ...... 256
13.29 Total variance explained for ‘legitimate power’ (questions 30c, 30h, 30m) ........................................................................... 256
13.30 Component matrix for ‘legitimate power’ (questions 30c, 30h, 30m) .. 257
13.31 Correlations for ‘expert power’ (questions 30d, 30i, 30n) ............ 257
13.32 Communalities for ‘expert power’ (questions 30d, 30i, 30n) .......... 258
13.33 Total variance explained for ‘expert power’ (questions 30d, 30i, 30n) ........................................................................... 258
13.34 Component matrix for ‘expert power’ (questions 30d, 30i, 30n) ...... 258
13.35 Correlations for ‘referent power’ (questions 30e, 30j, 30o) .......... 259
13.36 Communalities for ‘referent power’ (questions 30e, 30j, 30o) .......... 259
13.37 Total variance explained for ‘referent power’ (questions 30e, 30j, 30o) ........................................................................... 259
13.38 Component matrix for ‘coercive power’ (questions 30b, 30g, 30l) ....260
13.39 Correlations for ‘bases of power’ and the holistic power item (question 31) ........................................................................ 261
14.1 Results of multiple regression analysis – Model 1
Dependent variable: Length of hotel management contract ............ 265
14.2 Results of logistic regression – Model 2
Dependent variable: Type of FF&E reserve accounting approach applied ................................................................. 267

14.3 Results of multiple regression analysis – Model 3
Dependent variable: Adequacy of funds allocated to the FF&E reserve account .............................................................. 268

14.4 Results of multiple regression analysis – Model 4
Dependent variable: Hotel owner propensity to release FF&E reserve account funds .......................................................... 269

14.5 Results of multiple regression analysis – Model 5
Dependent variable: Single item index of sophisticated quantitative capital budgeting technique usage ................................. 272

14.6 Results of multiple regression analysis for proposition 5b
Dependent variable: Single item index of sophisticated quantitative capital budgeting technique usage ................................. 273

14.7 Results of multiple regression analysis – Model 5
Dependent variable: Multiple item index for sophisticated quantitative capital budgeting technique usage ............................ 275

14.8 Results of multiple regression analysis for proposition 5b
Dependent variable: Multiple item index of sophisticated quantitative capital budgeting technique usage ............................ 276

14.9 Results of multiple regression analysis – Model 6
Dependent variable: Index of emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal ................................................................. 278

14.10 Results of multiple regression analysis for proposition 6d
Dependent variable: Index of emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal ................................................................. 280

14.11 Results of multiple regression analysis
Dependent variable: Index of emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal ................................................................. 281

14.12 Results of multiple regression analysis – Model 6
Dependent variable: Holistic emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal ................................................................. 283
14.13 Results of multiple regression analysis for proposition 6b
Dependent variable: Holistic emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal ................................................................. 283

14.14 Results of multiple regression analysis for proposition 6e
Dependent variable: Holistic emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal ................................................................. 285

14.15 Results of multiple regression analysis – Model 7
Dependent variable: Propensity of hotel management to positively bias capital budgeting proposals ................................................................. 287

14.16 Results of multiple regression analysis for proposition 7a
Dependent variable: Propensity of hotel management to positively bias capital budgeting proposals ................................................................. 288
**LIST OF FIGURES**

<table>
<thead>
<tr>
<th>Figure</th>
<th>Description</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>Thesis overview</td>
<td>6</td>
</tr>
<tr>
<td>2.1</td>
<td>Healy’s typical bonus-plan remuneration scheme</td>
<td>13</td>
</tr>
<tr>
<td>4.1</td>
<td>The hotel management contract stakeholder network</td>
<td>31</td>
</tr>
<tr>
<td>6.1</td>
<td>Typology of hotel owner/operator structure and implications for capital budgeting formalisation</td>
<td>65</td>
</tr>
<tr>
<td>10.1</td>
<td>Model 1: Length of hotel management contract</td>
<td>150</td>
</tr>
<tr>
<td>10.2</td>
<td>Model 2: Choice of FF&amp;E reserve accounting approach</td>
<td>150</td>
</tr>
<tr>
<td>10.3</td>
<td>Model 3: Adequacy of funds allocated to the FF&amp;E reserve account</td>
<td>150</td>
</tr>
<tr>
<td>10.4</td>
<td>Model 4: Hotel owner propensity to release FF&amp;E reserve account funds</td>
<td>150</td>
</tr>
<tr>
<td>10.5</td>
<td>Model 5: Sophisticated quantitative capital budgeting technique usage</td>
<td>151</td>
</tr>
<tr>
<td>10.6</td>
<td>Model 6: Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal</td>
<td>152</td>
</tr>
<tr>
<td>10.7</td>
<td>Model 7: Propensity of hotel management to positively bias capital budgeting proposals</td>
<td>153</td>
</tr>
<tr>
<td>13.1</td>
<td>Scree plot for ‘factors influencing capital investment proposal go-ahead’ (question 8)</td>
<td>243</td>
</tr>
<tr>
<td>Appendix</td>
<td>Description</td>
<td>Page</td>
</tr>
<tr>
<td>----------</td>
<td>------------------------------------------------------------------------------</td>
<td>------</td>
</tr>
<tr>
<td>A</td>
<td>Flyer indicating endorsement of research</td>
<td>315</td>
</tr>
<tr>
<td>B</td>
<td>Interview request letter</td>
<td>316</td>
</tr>
<tr>
<td>C</td>
<td>Interview schedule</td>
<td>317</td>
</tr>
<tr>
<td>D</td>
<td>Ethics approval for face-to-face interviews</td>
<td>320</td>
</tr>
<tr>
<td>E</td>
<td>Ethics approval for questionnaire survey</td>
<td>321</td>
</tr>
<tr>
<td>F</td>
<td>Questionnaire cover letter - initial mailout</td>
<td>322</td>
</tr>
<tr>
<td>G</td>
<td>Questionnaire</td>
<td>323</td>
</tr>
<tr>
<td>H</td>
<td>Flyer containing research team biographies</td>
<td>327</td>
</tr>
<tr>
<td>I</td>
<td>Questionnaire cover letter - second mailout</td>
<td>328</td>
</tr>
</tbody>
</table>

References                                                                                     329
STATEMENT OF ORIGINALITY

This work has not previously been submitted for a degree or diploma in any university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

Signed: ..............................................

Michael James Turner
February, 2009
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CHAPTER 1
INTRODUCTION

1.1 Introduction

The broad objective of this thesis is to further our understanding of factors relating to the asset related expenditure practices of Australian hotels. This chapter serves to introduce the thesis. Theories and concepts informing the study are drawn from the literatures associated with agency theory and organisational power. A mixed methods research approach involving a qualitative interview phase followed by a quantitative survey phase has been used, which provides a strong foundation for developing significant insights into asset related expenditure practices in the Australian hotel sector.

The remainder of this chapter is organised as follows. The next section provides the motivation for the study. The subsequent section presents the study’s research objectives. The following section provides a background of the study. The penultimate section outlines the structure of the thesis and the final section provides a concluding commentary of the key issues raised in this chapter as well as a brief summary of the fifteen chapters comprising the thesis.

1.2 Motivation

Motivation for this study comes from several sources. The research topic appears highly appropriate given that little prior research has been directed towards investigating asset related expenditure practices of Australian hotels. In fact, there has been little accounting research focused on the hotel sector (Collier & Gregory, 1995a). The increasingly varied nature of international hotel environments and new ownership trends signifies that past research horizons may not fit well with the needs of future hotel corporations (Litteljohn, Roper, & Altinay, 2007). As a result, there is a need for more research to be conducted at the local, rather than the international level (Litteljohn, et al., 2007). As noted by Ittner and Larcker (2001), Chenhall (2003), and Cadez and Guilding (2008), investigating the role played by novel management accounting practices within contemporary settings is essential to ensure management accounting research relevancy.
This study adopts a mixed methods research approach, in light of calls for more management accounting research (see Birnberg, Shields, & Young, 1990) and tourism related research (see Davies, 2003) to be conducted in this manner. Throughout the study, a particular emphasis is placed on hotels operated via hotel management contracts, due to the unique agency issues that arise with separation of hotel ownership and management (Beals & Denton, 2005; Corgel, 2007a; Guilding, 2003; Schlup, 2004). A hotel management contract involves a hotel owner engaging the services of a hotel operator (typically a specialist hotel operating company) to operate its hotel. It is notable that the use of hotel management contracts is widespread and has been increasing ever since the early 1980s (see e.g. Beattie, 1991; Contractor & Kundu, 1998; Dave, 1984; Dunning & McQween, 1981; Eyster, 1997b; Litteljohn, 1991; Litteljohn & Beattie, 1992). Comparisons and contrasts are, however, made with other forms of hotel ownership / management structures. The significance of hotel management contracting is evident from the comments of Field (1995, p. 261):

For an area which has provided the basis of such a great part of the development of the hotel industry over the past 30 years, and is performing an even more important role in the 1990s, there has been remarkably little published research into the impact of management contracting within the hotel sector.

Guilding (2006, p. 402) also notes that:

The paucity of research focusing on the managerial implications resulting from this distinguishing commercial facet [i.e. hotel management contracts] is somewhat surprising.

Dickson, Williams and Lee (2008, p. 13) further comment:

The hotel industry needs to honestly ask itself whether sufficient attention is being given to research and development to explore whether improvement can be made to hotel management agreements.

Research into the hotel management contract is important as it may help provide clues with respect to how tension and the potential for acrimonious relationships arising between the contracting parties can be abated (Haast, Dickson, & Braham, 2005; Mellen, Nylen, & Pastorino, 2000).

A further important motivation of the study concerns the paucity of prior research into the locus of power between hotel owners and operators. The power issue can be seen to be important, as it is only when there is an equal balance in the relationship that both parties will be able to achieve their business goals over time (Armitstead, 2004). It is to be expected that
management contracts will be negotiated in the favour of the contracting party with greatest power (Rushmore, 2002). The literature suggests, however, that the locus of power is constantly shifting (Armitstead, 2004; Beals & Denton, 2005). It is notable that that the prior literature is based primarily on normative comment from a U.S. perspective (see Armitstead, 2004; Beals & Denton, 2005; Eyster, 1993; Hanson, 2007; W. Hart & Connor, 1994).

Investigation of hotel capital budgeting practices represents a major aspect of the thesis. This aspect is important as improvement of the capital budgeting process is often overlooked in hotels (Lynch, 2002). The capital budgeting process has also long been a source of frustration and pitfalls for owners (Denton & Yiankes, 2004). Indeed, although the capital budgeting decision is of enormous commercial significance in hotels, Guilding and Lamminmaki (2007, p. 3) note that it is surprising that “capital budgeting has commanded little interest amongst hospitality management researchers”. “Few, if any organizational decisions carry more profound implications for organizational success than the investment decision” (Guilding, 2006, pp. 400-401). Much of the reason for this lack of research is that hotels are fundamentally different to other commercial real estate operations (see Collier & Gregory, 1995a; Corgel, 2007a; Oak & Dalbor, 2008). Jones (1998) also notes the general lack of hotel capital budgeting research.

Capital budgeting is made more complex where hotels operate under a management contract (Guilding, 2003, 2006). For this reason, Guilding (2006, p. 420) recommends that “A further study could build on this research initiative by collecting survey data and comparing facets of investment appraisal systems in hotels owned by the operator with those of hotels operating a divorced owner / operator structure.”

A factor contributing towards the complexity of management contracting in hotels concerns the fact that the majority of management contracts require the owner to establish a reserve for the replacement of Furniture, Fittings, and Equipment (FF&E) (Haast, et al., 2005; Rushmore, 2002). It appears that use of an FF&E reserve can create considerable friction between hotel owners and operators with respect to three issues:

(1) management of allocations to, and disbursements from, the FF&E reserve (Australia New Zealand & Pacific Hotel Investment Conference, 2006a);
(2) the type of FF&E reserve account adopted (i.e. cash or notional) (Haast, et al., 2005); and
(3) the sufficiency of funds allocated to the FF&E reserve (Mellen, et al., 2000; Phillips, 2003).

These concerns expressed over reserve accounting provide a further motivation for the thesis.

Finally, the strategic focus and timing of capital expenditures is an important issue to hotel owners in their acceptance of the capital budget plan (West & Hughes, 1991). The importance of this issue also provides motivation for the study.

1.3 Research objectives

The eight specific research objectives of the thesis, together with the empirical research orientation relating to the way each objective has been pursued are presented in Table 1.1.

<table>
<thead>
<tr>
<th>Objective number</th>
<th>Objective</th>
<th>Empirical research orientation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>To investigate the nature of locus of power between hotel owners and operators.</td>
<td>Interview and survey</td>
</tr>
<tr>
<td>2</td>
<td>To investigate the different approaches to FF&amp;E reserve accounting in hotels.</td>
<td>Interview and survey</td>
</tr>
<tr>
<td>3</td>
<td>To advance understanding with respect to the sufficiency of funds allocated to the FF&amp;E reserve account.</td>
<td>Interview and survey</td>
</tr>
<tr>
<td>4</td>
<td>To advance understanding with respect to problems surrounding the release of funds from the FF&amp;E reserve account.</td>
<td>Interview and survey</td>
</tr>
<tr>
<td>5</td>
<td>To investigate the degree to which sophisticated capital budgeting techniques are applied in hotels.</td>
<td>Survey only</td>
</tr>
<tr>
<td>6</td>
<td>To investigate the relative importance of quantitative investment appraisal in hotels.</td>
<td>Interview and survey</td>
</tr>
<tr>
<td>7</td>
<td>To investigate the propensity of hotel management to positively bias capital budgeting proposals.</td>
<td>Interview and survey</td>
</tr>
<tr>
<td>8</td>
<td>To investigate whether hotel owner characteristics impact on the strategic focus and timing of capital spending.</td>
<td>Interview only</td>
</tr>
</tbody>
</table>
1.4 Background

On a global basis, the hotel industry has in recent years substantially increased its base of investors (Haast, et al., 2006). Much of the reason for this is that tourism is being accepted as a strong contributor to the global economy (Haast, et al., 2006). By 2010, for example, the global tourism industry is predicted to be the largest sector in the world, even surpassing the oil industry (Australia New Zealand & Pacific Hotel Investment Conference, 2007). Although the Australian hotel sector is relatively large, it is characterised by lower liquidity, a smaller market, a smaller pool of investors, and higher risk than other property sectors (Newell & Seabrook, 2004; Property Council of Australia, 2003). As a result, there is a need for the Australian hotel industry to become more widely accepted as a worthwhile investment target by a broader cross-section of investors (Sonnenblick-Goldman, 2005).

In recent years, a popular approach to attracting increased investment into the hotel industry has been to dramatically shift away from the traditional owner-operator hotel ownership model toward the use of management contracts (Haast, et al., 2006). Few hotels with more than twenty rooms, for example, are now owned and managed by the same entity (Corgel, 2007a). The use of management contracts, however, presents a challenge to the industry due to the agency issues that arise from the separation of ownership and management. Management contracts, however, have allowed many different types of investor to own hotels, such as private equity firms, real estate investment trusts, high net worth individuals, developers, and opportunity funds (Haast, et al., 2006). The exact composition of hotel investment, however, differs considerably across countries (Haast, et al., 2006).

In attracting greater investment it is important for Australian hotels to recognise that they are competing against other countries in the international tourism market and must therefore be in good physical condition to satisfy the requirements of both international and domestic travellers. To stimulate further investment, development, and long-term competitiveness, periodic capital investments are necessary (Property Council of Australia, 2003). The growth and maintenance of property values in the hotel industry as well as high levels of guest satisfaction and occupancy are, for example, highly contingent upon capital investment (Harper & Fiacchi, 1996; Mellen, et al., 2000).
Hoteliers will also need to recognise that capital spending represents a significant cost. In 2002, for example, to generate $8 billion of income, the Australian accommodation industry spent more than $1.12 billion on capital investment projects (Australian Bureau of Statistics, 2002). As rising construction costs further curtail the new supply of hotels coming into the Australian market (Colliers-International, 2007), the hotel industry will need to change some of its approaches toward dealing with capital costs, as the need to renovate, refresh and maintain existing hotel assets becomes even more critical to their survival and success (Brooke & Denton, 2007). As a result, there is an overarching need for the hotel industry to “come clean” on the issue of how much needs to be spent on capital investment so that more capital can be attracted to the industry (Mellen, et al., 2000, pp. 2-3).

1.5 Thesis structure

Bryman and Cramer (1990) offer a useful model to provide an overview of a thesis’ structure. This model has been adapted to the research method adopted in this study and appears in Figure 1.1.

![FIGURE 1.1 Thesis overview](image-url)
As Figure 1.1 illustrates, the thesis is comprised of fifteen chapters. Each of the subsequent chapters will now be discussed in turn.

Chapter 2 reviews the main theories informing the study. The main theoretical framework reviewed is agency theory. In addition to agency theory, the related organisational power literature is reviewed.

Chapter 3 reviews several areas of the literature associated with hotel operational structures.

Chapter 4 provides a novel discussion of the main stakeholders involved in a hotel management contract. Particular emphasis is placed on the use of hotel management contracts in this thesis due to the unique agency issues that arise from their use.

Chapter 5 provides an overview of the management accounting capital budgeting literature. Due to size and scope limitations, the review focuses on topics considered most pertinent to this thesis, which include the use of both quantitative and qualitative capital budgeting techniques as well as issues associated with the biasing of capital budgeting proposals.

Chapter 6 reviews several areas of the hotel capital budgeting literature, which include: (1) a general overview of the capital budgeting process in hotels; (2) the use of quantitative and qualitative capital budgeting techniques in hotels; (3) biasing of hotel capital budgeting proposals; and (4) use of the Furniture, Fittings, and Equipment (FF&E) reserve in management contract operated hotels.

Chapter 7 provides a novel discussion of deficiencies in hotel owner and operator capital expenditure goal congruency in hotel management contracts. The review concludes that a better method for owners to remunerate operators is through the use of return on investment (ROI) or residual income (RI).

Chapter 8 outlines the mixed methods research methodology adopted in this study due to the use of two empirical phases, which include a series of exploratory interviews followed by the administration of a questionnaire survey. Issues associated with the strengths, weaknesses, reliability and validity of both approaches are discussed along with a more general examination of the merits of adopting a mixed methods approach.
Chapter 9 describes the findings of the exploratory interview phase of the study. The chapter begins with a discussion of the interview sample and the interview schedule. Following this, findings relating to each of the study’s research objectives are discussed in sequential order.

Chapter 10 draws on material presented in the literature review and interview findings’ chapters to describe the propositions that have been developed for testing using quantitative data collected in the questionnaire survey phase of the study. The chapter provides a diagrammatic overview of the underlying propositions developed using seven models that highlight the independent and dependent variables. Each proposition is discussed sequentially.

Chapter 11 introduces the questionnaire survey questions that are used to measure the study’s independent and dependent variables. The chapter begins by providing an overview of general issues in questionnaire design and pilot testing. Following this, a description of the measures used is provided in the order that they appear in the questionnaire.

Chapter 12 is the first of three chapters concerned with the collection and analysis of quantitative data. The chapter describes the administration of the questionnaire survey, data screening, and descriptive statistics concerning each of the questionnaire questions posed.

Chapter 13 provides an investigation of those variables that will be involved in proposition testing that were measured using more than one item in the questionnaire. The thrust of the chapter concerns determining the degree to which the items used to measure the variables are measuring the same underlying theme or construct.

Chapter 14 provides the results of the statistical testing of each of study’s propositions. The main form of multivariate analysis used is multiple regression.

Chapter 15 provides a synthesis and discussion of the study’s main findings. The study’s limitations and avenues for further research are also provided.
1.6 Conclusion

This chapter has introduced the thesis by outlining the topic of the study, the motivation for the work, the research objectives pursued, and the thesis structure. At the outset of the study, it is believed that the research has the potential to provide significantly to the limited hotel management accounting literature on asset related expenditure. The study is also believed to provide an opportunity to enhance our understanding of the explanatory power of several theoretical models. The following chapter provides detailed discussion of the agency theory literature as well as the organisational power literature. These literatures are drawn upon extensively in the thesis.
CHAPTER 2
THE AGENCY THEORY AND ORGANISATIONAL POWER LITERATURES

2.1 Introduction

This chapter reviews two domains of literature that have informed this study. It commences with a broad review of the agency theory literature and follows with a discussion of the organisational power literature. The chapter concludes with a summary of the key issues raised.

2.2 The agency theory literature

A substantial literature exists on the agency problem and the associated goal incongruence between principals and agents (see e.g. Baiman, 1990; Berle & Means, 1932; Fama, 1980; Jensen & Meckling, 1976). The pioneers of agency theory were Jensen and Meckling (1976) who describe an agency relationship as arising when there is a contract whereby one party (the principal) appoints another party (the agent) to perform some service on behalf of the principal. Agency theory is also the central approach to the theory of managerial behaviour (S. Ross, 1987) and can be seen to have an unrelenting importance in many economic disciplines, including accounting (Demski & Feltham, 1978). Ekanayake (2004) points out, however, that it is vitally important to remember that agency theory tends to capture the way that agents behave in Western cultures, which can be fundamentally different from other cultures, particularly in Asia (Nanayakkara, 1992; O'Connor & Ekanayake, 1998; Sharp & Salter, 1997; Taylor, 1995; Wijewardena, 1992; Wijewardena & Wimalasiri, 1996).

Agency theory has two branches (Eisenhardt, 1989; Jensen, 1983). The first branch is called ‘positivist agency research’, which focuses on goal conflicts between principals and agents (Ekanayake, 2004). This has involved investigations into the relationship between principals and agents and the way in which principals can police the behaviour of an agent (see e.g. Bhagat, Brickley, & Lease, 1985; Demsetz & Lehn, 1985; Jensen & Meckling, 1976). The second branch is called ‘principal-agent research’, which develops a general theory that applies to superior-subordinate, employer-employee, and manager-worker relationships (Eisenhardt, 1988; Gomez-Mejia & Balkin, 1992; Govindarajan & Fisher, 1990; Roth & O'Donnell, 1996).
As outlined by Dimou, Chen, and Archer (2003), the fundamental agency problem revolves around goal conflict between principals and agents. This problem, combined with uncertainty and information asymmetry, can lead to the problems of adverse selection and moral hazard. Adverse selection occurs when employee-managers are compensated through contracts that involve fixed salaries, which creates incentives for job applicants to overstate their competence and is exemplified in situations where there is significant information asymmetry that favours the applicant. The second major problem, moral hazard, is the name given to the increased risk of problematic, or immoral behaviour, which has negative connotations because the person who causes the problem does not necessarily suffer the full (if any) consequences, or may even benefit. This situation usually arises in the presence of asymmetric information that favours the agent. To overcome such problems, principals typically need to incur significant monitoring costs to watch over the agent’s behaviour. Such an approach can also lead to the undesirable problems of free riding and inefficient risk bearing.

The propensity for principal-agent conflict arising is explored by Lambert (2001), who identifies four distinct situations in which conflict between principal and agent are likely to occur, which include: (1) where the agent could potentially be averse to effort; (2) where the agent can use their work situation as an opportunity to divert resources toward their own personal benefit; (3) where there are differential time horizons between principal and agent; and (4) where the principal and agent hold different preferences and attitudes to risk.

The typical problem encountered in agency relationships, sees the agent seeking to achieve short-term goals, whilst the principal desires the achievement of longer-term goals (Lambert, 2001). This is because principals generally recognise that for a business to be successful it needs to earn profits over a period of years and sometimes short-term gains must be sacrificed in order to achieve more profitable longer-term goals (P. J. Harris & Hazzard, 1987). When the anticipated term of the agent is shorter than the firms’ optimal investment horizon, this is known as the ‘horizon problem’ (Dechow & Sloan, 1991; Ittner, Larker, & Rajan, 1997; B. Johnson, 1987; C. W. Smith & Watts, 1982). The ‘horizon problem’ can lead agents to proceed with lower Net Present Value (NPV) projects that yield high current-period accounting earnings as compared to higher NPV projects that provide low current period earnings (Baber, Kang, & Kumar, 1998). To restrict dysfunctional behaviour of this type, one
option is for principals to employ forceful agents who have the persistence and personality to pursue projects that deliver viable returns over the longer-term (P. J. Harris & Hazzard, 1987). Despite the merits of such an approach, however, businesses have learned that it is in human nature to pursue self-interest so they have steered towards the preparation of contracts between principals and agents that outline various terms and conditions dealing with the employment of the agent (P. J. Harris & Hazzard, 1987). These contracts usually stipulate certain conditions regarding remuneration and how bonuses will be assessed (P. J. Harris & Hazzard, 1987). Bonus schemes are, however, not always advantageous to the principal as they can lead to gamesmanship and a lack of cooperation from the agent (Beer & Katz, 2003). For example, if bonuses are too high, agent behaviour and decision-making can suffer (Beer & Katz, 2003). As a result, the agency problem can sometimes be worsened through the use of a bonus scheme. On the other hand, the absence of a bonus scheme may lead to deficient performance from the agent. Achieving the right balance is therefore very important when attempting to ensure an agent’s behaviour is linked with a principal’s goals.

A good illustration of the way in which an agent can be expected to behave in the presence of a bonus scheme is provided by Healy (1985). Healy (1985) explains how the remuneration conditions that exist between a principal and an agent can cause the agent to make profit increasing or profit decreasing accounting policy choices. Figure 2.1 shows that: (1) if profit is between the bogey (minimum bonus) and the cap (maximum bonus) the agent will be motivated to engage in profit increasing accounting policy choices until the cap is reached; (2) if profit exceeds the cap, agents have an incentive to engage in profit decreasing accounting choices as these will not affect bonuses received in the current period but will allow a greater opportunity to achieve a high profit and bonus in future accounting periods; (3) if profit is beneath the bogey, there are motivations for the agent to engage in profit increasing accounting choices in order to bring profit into the region between the bogey and cap; and (4) if profit is significantly beneath the bogey, and there is no chance for the agent to reach the area between the bogey and the cap, there are incentives for the agent to ‘take a bath’ by selectively bringing forward any potential expenditure from future periods to the current period so as to allow for a greater potential for higher profit and bonuses in future periods.
The extent to which Healy’s (1985) hypotheses are tenable, however, is not clear-cut. Some research has supported Healy’s (1985) findings (see Bernard & Skinner, 1996; Dechow, Sloan, & Sweeney, 1995; Holthausen, Larcher, & Sloan, 1995; J. Jones, 1991; Kaplan, 1985; McNichols & Wilson, 1988; Schipper, 1989), while other studies (see DeFond & Park, 1997; Gaver, Gaver, & Austin, 1995) have not. Recent evidence, however, does tend to support Healy’s findings (see Nelson, Elliott, & Tarpley, 2003; Palliam & Shalhoub, 2003).

In conjunction with the remuneration of agents, it is also important for principals to develop an effective performance measurement system that is relevant to their particular business strategy and competitive environment (Fitzgerald & Moon, 1996). A business also needs to consider the various stakeholders involved and the relative weighting toward the requirements of the performance measures used (Bhimani, 1993; Harper, 1984). To achieve such outcomes, there has been a marked increase in the use of performance measurement systems that utilise both financial and non-financial measures (Haktanir & Harris, 2005). In connection with financial performance appraisal measures, for example, one of the most common is operating profit (Dutta, 2003). A major problem with this approach, however, is that it does not deduct any charge for the use of capital (Dutta, 2003). As a result, much criticism has been levelled at the use of financial performance measures because they tend to
over-emphasise short-term accounting returns at the expense of longer-term investments (Bushman, Indjejikian, & Smith, 1996; Dechow & Sloan, 1991; Deloitte & Touche, 1994; Kaplan & Atkinson, 1998; Kaplan & Norton, 1992; C. W. Smith & Watts, 1982). Empirical evidence suggests, however, that the use of accounting earnings as a performance measure is far more useful than stock returns (Baber, Janakiraman, & Kang, 1996; Holstrom, 1979; Jensen & Murphy, 1990; Lambert & Larker, 1987; Sloan, 1993). Indeed, agency costs can be mitigated through the use of performance measures that are more precise and sensitive to an agent’s effort (Banker & Datar, 1989; Holmstrom & Milgrom, 1987). As a result, it is considered an inadequate basis for control to focus on profits without considering the assets employed to generate those profits (Anthony & Govindarajan, 2007). Such criticisms of operating profit as a performance measure have led to an increased use of other financially oriented performance appraisal measures, such as return on investment (ROI) and residual income (RI) (D. S. Young & O'Byrne, 2001).

Regardless of the amount of contracting that principals and agents engage in, the agency problem cannot be entirely eliminated and certain agency costs are bound to be incurred by the principal (see Bazerman, Neale, Valley, Zajac, & Kim, 1992; Kesner, Shapiro, & Sharma, 1994). This problem arises due to the incompleteness of contracts (Bernheim & Whinston, 1998; D. Hart & Moore, 1988, 1999; Maskin & Tirole, 1999; Williamson, 1985). Jensen and Meckling (1976) identified three categories for these costs: monitoring costs, bonding costs, and residual loss. Drawing upon the description of these three cost categories given by Holmes, Hodgson and Godfrey (2000), monitoring costs are said to be the costs of monitoring an agent’s behaviour and are initially borne by the principal, who may then attempt to pass them on to the agent in the form of lower remuneration. The magnitude of these costs often depends on the reputation of the agent. If an agent’s reputation is good, for example, then less monitoring is needed because the agent can be trusted to deliver an appropriate service. On the other hand, if the agents’ reputation is poor or uncertain, then the principal will wish to monitor the agent more closely and the costs of monitoring will therefore be higher. In the years since the work of Jensen and Meckling (1976), it is also pertinent to note that other commentators (see e.g. Sharma, 1997; Williamson, 1985) have

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1 As a detailed discussion of ROI and RI are provided in Chapter 7, such a discussion is not presented in this chapter.
advocated that in addition to monitoring costs, there are also ‘metering costs’, which refer to the measuring of outcomes.

The second category of costs associated with contracting are called ‘bonding costs’. As outlined by Holmes, Hodgson and Godfrey (2000), these costs are associated with connecting an agent’s interests to those of the principal. The agent bears the burden of these costs. For example, an agent may decide to voluntarily prepare information, such as quarterly financial reports, in order to demonstrate to the principal that they are acting in the principal’s best interests. It appears it is the agent who ultimately bears the burden of both monitoring and bonding costs. The amount of monitoring and bonding costs that an agent incurs can be thought of as a balanced set of scales. On one side are the monitoring costs, which are associated with the relative trust that the principal has in the agent. On the other side are the bonding costs and an agent will increase their investment in bonding costs until the marginal benefit equals the marginal cost of reducing monitoring costs.

The final category of contracting costs is known as residual loss, which recognises that the sheer presence of monitoring and bonding costs within an agency relationship leads to a deadweight loss. That is, despite the fact that the principal sets up procedures to align an agent’s interests with their own, there will inevitably be some situations where the interests of the agent and the interests of the principal diverge.

This section has reviewed the literature associated with agency theory. A second literature that is important to this study, which is related to the agency literature, is known as the organisational power literature. This literature examines the propensity of agents to wield power over another party (the target) so as to make the target act in accordance with the agent’s wishes (Bass, 1990). The following section provides a summary of the organisational power literature most pertinent to this study.

2.3 The organisational power literature

Within the social sciences, power has been investigated in a wide variety of contexts (see Keltner, Gruenfeld, & Anderson, 2003) but at the organisational level, the study of power branches into three distinct but overlapping areas, which include: (1) the intraorganisational power literature, which investigates power between individuals within the same organisation
(see Brass, 2002 for a comprehensive review); (2) the organisational power literature, which studies the power of individuals and groups relative to their relationship with and their dependence on the organisation (see Ocasio, 2002 for a comprehensive review); and (3) the interorganisational power literature, which examines power between organisations (see Mizruchi & Yoo, 2002 for a comprehensive review). The main point of difference between the three power literatures, however, is only that the actors change. For example, the actors may be people (intraorganisational), groups (organisational), or organisations (interorganisational) (Brass, 2002). The theories of power can therefore be applied across all three different levels of analysis (Brass, 2002).

Under all three branches of the organisational power literature, power is viewed as “a change in the belief, attitude, or behavior of [an actor] … which results from the action or presence of another [actor]” (Raven, 1990, p. 495). Within this definition it is important to note that the “intentionality” of power needs to be addressed (Cartwright, 1965, p. 11; Fairholm, 1993, pp. 8-9). This concept outlines that the term ‘power’ should only be used for those actions that are carried out intentionally. For example, to include the unintended outcomes of wielding of power would render the term too broad and would capture every conceivable action (Krause & Kearney, 2006).

A further important issue in a discussion of power is that although many authors use the terms power (i.e. actual power) and influence (i.e. the ability to wield power) interchangeably (see e.g. Argyle, 1990; Cartwright, 1959; Giddens, 1984; Kelman, 1974; Pfeffer, 1992), it is important to distinguish between the two terms (B. Barry & Watson, 1996; Krause & Kearney, 2006). Nevertheless, many power researchers continue to define ‘power as an ability’ (see e.g. Cartwright, 1959; Etzioni, 1968; Fairholm, 1993; Hinkin & Schriesheim, 1989; Thibaut & Kelley, 1959). Such a definition, however, fails to recognise that power is always a reciprocal interaction between an agent (A) and another party (B) (Emerson, 1962; Etzioni, 1968; Mintzberg, 1983). For example, by not recognising this reciprocal interaction, it would lead to a failure to appreciate that the power of A not only depends on the available resources of A, but also on the demand for those resources by B, as well as the opportunity of B to obtain those desired resources from another party (Thibaut & Kelley, 1959). In this way, B plays an active role in their relationship with A (Krause & Kearney, 2006). This aspect of power relations is often referred to as the “relationality” of power relations (see Fairholm, 1993, p. 7; Hardy & O'Sullivan, 1998, pp. 462-463).
According to Krause and Kearney (2006), power relations are typically interdependent (Giddens, 1984). Nevertheless, power in relations between A and B are typically imbalanced (Friedberg, 1992) due to a mismatch in the distribution of the power between the pair. For this reason, it is common to find that conditions of superordination and subordination (dominance and submission) come into play (Krause & Kearney, 2006). It must also be recognised, however, that in a situation where A has power over B, and B has power over C, it remains unclear as to whether A can also wield power over C (Friedberg, 1992). Much of the reason for this is that the lack of research into multiple-actor situations still leaves such central questions largely unanswered (Brass, 2002).

As indicated earlier, the mere fact that A might have power over B does not necessarily mean that A will wield that power (Emerson, 1962; Etzioni, 1968; Mintzberg, 1983). Within the literature, this concept is known as ‘potentiality’, which distinguishes between potential power and actualised power (Cartwright, 1959; B. E. Collins & Raven, 1969; Etzioni, 1968; Raven, 1992). As Krause and Kearney (2006) explain, potential power is the discrepancy between all the resources of A compared to all the resources of B. On the other hand, actualised power refers to all the resources that A utilises in a specific situation in relation to the resources deployed by B. Based on this reasoning, it can be seen that the propensity for A to draw down on all of their resources to wield power over B is constrained by the costs involved in doing so by both parties. For example, A must incur costs in overcoming B, whereas, B will incur costs to resist A. Therefore, each agent will incur costs to affect the attitude and/or behaviour of the other party to the point where the costs equal the benefits. For this reason, the greater the potential power of A, the greater is the likelihood that they will wield power over B (Kipnis, 1976) and also restrict B’s action options (Scholl, 1999) because power corrupts (Kipnis, 1976; Snyder & Kiviniemi, 2001).

Krause and Kearney (2006) also note that another important concept in power relations is the level of “dependency” (Fairholm, 1993, pp. 11-13; Hardy & O'Sullivan, 1998, p. 462). Emerson (1962, p. 32) explains that:

… the dependence of actor A upon actor B is (1) directly proportional to A’s motivational investment in goals mediated by B, and (2) inversely proportional to the availability of those goals to A outside the A-B relation.
Within Emerson’s (1962, p. 32) definition, he highlights that “goals” are taken to mean the “gratifications consciously sought as well as rewards unconsciously obtained through the relationship”. With respect to the “availability of those goals to A outside of the A-B relation”, this refers to the “alternative avenues of goal-achievement, most notably other social relations” (Emerson, 1962, p. 32). Therefore, the greater is B’s dependency on A, the greater will be A’s power over B.\(^2\) Where B seeks to pursue alternative avenues of goal-achievement, however, the costs of such an approach must be included in the assessment of dependency (Emerson, 1962).\(^3\) 

This section has highlighted that there are four attributes that are central to the term power in the organisational power literature, which include: (1) the availability and demand of resources; (2) relationality; (3) dependency; and (4) intentionality.

### 2.4 Conclusion

The objective of this chapter has been to provide an overview of the agency theory literature and the organisational power literature. It has been noted that a substantial literature exists on the agency problem and the associated goal incongruence between principals and agents (see Baiman, 1990; Berle & Means, 1932; Fama, 1980; Jensen & Meckling, 1976). The typical problem encountered in an agency relationship sees the agent seeking to achieve short-term goals, whilst the principal desires the achievement of longer-term goals (Lambert, 2001). The problem is exacerbated in the presence of information asymmetry favouring the agent. To overcome the agency problem, principals have steered towards the preparation of contracts that deal with the remuneration and bonuses of the agent (P. J. Harris & Hazzard, 1987). Regardless of the amount of contracting, however, the agency problem cannot be entirely eliminated and agency costs will be incurred by the principal (see Bazerman, et al., 1992; Kesner, et al., 1994).

Related to the agency theory literature, the second section of the chapter examined the organisational power literature, which is concerned with the propensity of agents to wield power over another party (the target) so as to make the target act in accordance with the

\(^2\) As outlined by Krause and Kearney (2006), a similar form of the concept of dependency can be found in the exchange theory proposed by Thibaut and Kelley (1959).

\(^3\) Emerson (1962, p. 32) explains that the notion of “opportunity costs” in economics is a similar idea.
agent’s wishes (Bass, 1990). Within the organisational power literature, there are three branches: (1) the intraorganisational power literature, which investigates power between individuals within the same organisation (see Brass, 2002 for comprehensive a review); (2) the organisational power literature, which studies the power of individuals and groups relative to their relationship with, and their dependence on, the organisation (see Ocasio, 2002 for comprehensive a review); and (3) the interorganisational power literature, which examines power between organisations (see Mizruchi & Yoo, 2002 for a comprehensive review). The main point of difference between the three power literatures, however, is only that the actors change. For example, the actors may be people (intraorganisational), groups (organisational), or organisations (interorganisational) (Brass, 2002). In this way, the theories of power can be applied across all three levels of analysis (Brass, 2002). Four attributes are therefore central to the term power, which include: (1) the availability and demand of resources; (2) relationality; (3) dependency; and (4) intentionality. The next chapter reviews several areas of the literature concerned with categories of hotel owner and hotel operational structures.
CHAPTER 3
HOTEL OPERATIONAL STRUCTURES

3.1 Introduction

This chapter reviews the literature associated with different forms of hotel owner/operator operational structures. Following an overview of the three main owner/operator operational forms, the chapter concludes with a summary of the key issues.

3.2 Hotel operational structures

Regardless of how the assets of a hotel are owned, hotel owners are typically faced with a number of choices regarding their operational structure. Owning a hotel does not signify operating a hotel, because in many cases the hotel owning entity does not operate the hotel (Hayes & Ninemeier, 2004). On an international basis, the three main hotel operational methods are the owner-operator, franchise agreement and management contract (Gannon & Johnson, 1997). The following sections describe each of these common hotel ownership structures in more detail.

3.2.1 Owner-operator

The old adage that ‘if you want a job done well, do it yourself’ applies to hoteliers that choose to own and operate a hotel, as this avoids any loss of control over day-to-day operations (H. M. Field, 1995). Owner-operators typically purchase a hotel “for a cluster of

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1 It is possible to conceive of a fourth category, which is the joint venture. Although there are two separate owners in such a situation, they essentially form an owner-operator structure through each owner’s partial ownership (Contractor & Kundu, 1998). Use of joint ventures appears particularly widespread in parts of Asia (particularly China) as a result of laws and regulations that prevent whole ownership from foreign investors (see e.g. Kivela & Leung, 2005; Van der Linden, 2007). In more developed markets, however, although joint ventures may appear favourable in theory, forecasted benefits often do not accrue (Canina, 2001). In the U.S., for example, fewer than half of the hotel consolidations between 1982 and 2000 created any value (Canina, 2001). As explained by Bader and Lababedi (2007, p. 179), there has also been an emergence of what are called “manchises”, whereby hotel owners engage a hotel operating company [under a management contract] for an initial period of time, say three to five years, after which the contract reverts to a franchise contract whereby the owner assumes management responsibility and retains the operator’s brand, for which an annual franchise fee is payable … This is particularly advantageous to help hotel operating companies launch new brands.” There is also another hybrid called a “man-lease”, which takes the shape of a lease but has many of the commercial terms of a management contract (Dickson, 2007, p. 4). Under this arrangement, the risk of hotel operations remains with the owner. This approach is used in certain jurisdictions, such as Australia, to deal with issues that arise under local law (e.g. tax laws) (Dickson, 2007).
lifestyle reasons” (Lashley & Rowson, 2007, p. 122). Few owner-operators have any “classic entrepreneurial ambitions to make a lot of money” but rather have held a “lifelong ambition to own a hotel … because they think they will enjoy the life of hotel ownership” (Lashley & Rowson, 2007, p. 122). A major problem arises, however, as few owner-operators have had any hotel work experience or possess appropriate management skills. This often results in the reality of hotel ownership not matching owner expectations, or worse still, outright business failure (Lashley & Rowson, 2007). Much of the reason for these difficulties is that owner-operator hotels are slow to adapt to new economic environments, which can: (1) lead to difficulty in gaining access to funding from outside sources (Hilary, 1995); (2) undermine attempts at asset repositioning (Hilary, 1995); (3) prevent necessary capital spending (Cai & Perry-Hobson, 2004; Hassanien & Baum, 2002; K. Smith & Jones, 2005); and (4) make it difficult to recruit skilful and experienced general managers due to a lack of promotional opportunities (Gannon & Johnson, 1997). As a result, the use of the owner-operator hotel ownership structure is dwindling in many of the more developed Western markets, such as the U.S., Europe, Australia, and New Zealand (Gross-Turner, 1999; Ingram & Baum, 1997; P. Jones, 1996; Phillips, 2003; Slattery, 1992). There is also little use of the owner-operator hotel ownership structure in the burgeoning new economies of India, China, and other parts of Asia (Haast, et al., 2006). As a result, usually only ‘flagship’ properties remain independently owned and operated (Gannon & Johnson, 1997).

Despite the lack of competitiveness of some of the smaller and medium sized owner-operated hotels in Australia, many of them are considered by the Federal Government to be important to local economies and for this reason these hotels often receive grants, subsidised loans and assistance with promotions, advertising and purchasing (Lee-Ross, 1998). Notwithstanding these incentives, many owner-operators are in the midst of an evolution toward a greater use of the more specialised ownership structures, such as management contracts and franchising (Denton, 1998).

3.2.2 Franchise

Based on the works of Angelo and Vladimir (1994), Kasavana and Brooks (1995), Knowles (1996), and Vallen and Vallen (1999), Garcia-Falcon and Medina-Munoz (1999, p. 106) define a hotel franchising arrangement as a situation where:
For a fee, an independent hotel [i.e. owner-operator] adopts the franchiser's name and trademarks and receives services in return, including the preparatory steps of feasibility, site selection, financing, design, and planning. Almost all the advantages of the chain are available for the franchisee: mass purchasing, management consultation, wide advertising, central reservations, and systems designs.

As is evident from Garcia-Falcon and Medina-Munoz’s (1999) definition, franchising is a popular approach among previously independently owned and operated hotels, because the hotels can gain access to the benefits of being part of a chain through the adoption of a franchiser's name and trademarks and services. An upfront fee as well as sales royalties of approximately ten per cent of annual rooms revenue, however, is typically paid by the franchisee to the franchisor for these services (Angelo & Vladimir, 1994; Caves & Murphy-III, 1976; Kalnins, 2004; Kasavana & Brooks, 1995; Knowles, 1996; Vallen & Vallen, 1991). In other industries this figure is closer to one or two per cent (Withiam, 1995). Despite this relatively high cost, studies (see e.g. Fladmoe-Lindquist & Laurent, 1995; Huszagh, Huszagh, & McIntyre, 1992; Kedia, Ackerman, Bush, & Justis, 1994; Shane, 1996) show that in both developed and emerging markets, conditions continue to become more favourable for hotels to use franchising arrangements as opposed to owner-operator structures. It is relevant to note, however, that hotel franchises are still relatively uncommon in Asia (Dickson, 2007, p. 4).

Much of the reason for the general increase in franchising stems from it offering a range of benefits to the owner of a hotel, which include: (1) less capital required relative to the owner-operator structure (Go & Christensen, 1989); (2) it can enable access to the benefits of internationalisation with far less risk than other strategies, such as direct investment (Aydin & Kacker, 1990); (3) it can facilitate an effective expansion strategy (Castrogiovanni & Justis, 1998; Cho, 2005); (4) it can allow large geographical coverage without high parent company costs (Go & Pine, 1995; Tse & West, 1992; S. Young, Hamill, Wheeler, & Davis, 1989); and (5) it can provide a more stable cash flow compared to the management contract form of hotel operational structure (Combs & Ketchen, 1999; Madanoglu & Olsen, 2005; Minkler & Park, 1994). A disadvantage of the franchise arrangement, however, is that it elevates the incidence of agency issues relative to the owner-operator structure. The owner must therefore implement careful governance mechanisms, which can become prohibitively expensive (Fama & Jensen, 1983; Singh, Schmidgall, & Beals, 2004). A further problem is that franchising can bring about encroachment issues whereby a franchisee has their market
diminished by a new same name franchisee that moves into a close-by geographical location (Kalnins, 2004; Khanna & Ganot, 1995; Sheridan & Gillespie, 1995). Indeed, the problem of encroachment is much more prevalent in franchises than in other forms of hotel ownership structure (Blair & Lafontaine, 2002; Chung & Kalnins, 2001; Fischer & Harrington, 1996).

3.2.3 Management contract

The separation between ownership and management through the use of a hotel management contract is becoming much more widespread (Beals & Denton, 2005; Corgel, 2007a; Panvisavas & Taylor, 2006) and is one of the driving mechanisms for the rapid internationalisation of the hotel industry (Beattie, 1991; Dave, 1984; Dunning & McQween, 1981; Eyster, 1997b; Litteljohn, 1991; Litteljohn & Beattie, 1992).² Few hotels with more than twenty rooms, for example, are owned and managed by the same entity (Corgel, 2007a). Table 3.1, highlights the predominance of the management contract across North America, Europe and Asia in the late 1990s. Further, Slattery (1996) noted 75% of listed Asian hotels operating under a management contract. As cited by McCarthy and Raleigh (2004), more recent evidence from Smith Travel Research (2003) indicates that management contract use in the U.S. has further increased. Contractor and Kundu (1998) found 41% of US hotels had a management contract, while Smith Travel Research (2003) noted an increase to 55%. Beals and Denton (2005), Panvisavas and Taylor (2006), and Corgel (2007a) have provided further recent testimony to the increasing popularity of management contracts.

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<td>Distribution of hotel ownership modal types across major regions of destination (percentage)</td>
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<td>Modal choice</td>
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<tr>
<td>Owner-operator (fully owned)</td>
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<td>Owner-operator (partially owned, e.g. joint venture)</td>
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<td>Franchise agreement</td>
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<td>Management contract</td>
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<td>Adapted from: Contractor and Kundu (1998)</td>
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² A selection of prominent operators and brands in the Asia-Pacific region provided by Dickson (2007, p. 2) include: Accor (Sofitel, Novotel and Ibis); Fairmont Raffles (Raffles, Swissôtel); Four Seasons; Hyatt (Grand Hyatt); InterContinental (InterContinental, Crowne Plaza, Centra and Holiday Inn); Marriott (Renaissance); Mirvac (Sebel, Citigate, Quay West); Shangri-La (Shangri-La); and Westin (Aloft, Westin).
Much of the reason for the popularity of management contracts is that hotels are expensive to build, and require a high level of knowledge and technology in marketing and professional management to operate effectively. The expertise required to operate a large hotel is more readily available in such an arrangement (H. M. Field, 1995). It enables hotel owners to derive the benefits of owning a hotel without the requirement of having to operate it (Horwath & Horwath, 1988). The proliferation of hotel management contracts has seen the establishment of many global hotel brands and the disappearance of some domestic local brands (Cai & Perry-Hobson, 2004).

Although there is no standardised management contract (K. Johnson, 1999), Schlup (2004, p. 23) defines a management contract as:

.... a written agreement between the owner of a hotel and an operator, by which the operator is appointed to operate and manage the hotel in the name, on behalf of and for the account of the owner and the operator is to receive a management fee in return.

Drawing on the works of Angelo and Vladimir (1994), Kasavana and Brooks (1995), Knowles (1996) and Vallen and Vallen (1999), a hotel management contract can be expressed as:

An agreement between a property owner and a management company, who agrees to take on operational responsibilities. The owner, on the other hand, agrees to finance and build the property, if this is not yet done, and to pay for the management services (Garcia-Falcon & Medina-Munoz, 1999, p. 106).

A management contract enables a hotel owner to retain legal ownership of the hotel site, building, plant and equipment, furnishings and inventories, while the operator is responsible for the day to day business of the hotel (Guilding, 2003). The owner assumes full economic risk associated with ownership of the commercial asset, whereas, the operator is only responsible for the operation of the hotel (Schlup, 2004).

A major reason for the increased use of hotel management contracts is that they offer a wide range of benefits. Hotel owners have discovered that bottom-line returns and property values can be improved through the adoption of a brand via a hotel management contract (Gross-Turner, 1999; O'Neil & Mattila, 2006; O'Neil & Xiao, 2006). Affiliation to a brand can also offer consistently reliable quality as well as greater recognition from consumers and investors (Withiam, 1993). Outside investors can be more inclined to invest in a hotel operated under a
management contract (Horwath & Horwath, 1988; Livingston, 1977). Credibility can also be gained among financial institutions due to trading names, operating expertise and resources, buying power, sophisticated referral systems and superior training systems (Collier & Gregory, 1995a; Horwath & Horwath, 1988). Vendors also typically offer better volume discounts (Koss-Feder, 1994) and hotel owners can enjoy stable and sustained growth of their hotel asset with very little real-estate exposure (Anwar, 2000).

Management contracts do have some disadvantages, however. Despite its popularity, the management agreement is the most problematic of all operating concepts in the hospitality industry (Schlup, 2004). The main problems concern agency issues that arise from the separation of ownership and management (Schlup, 2004). This relationship can create a volatile mix of economics and power that can explode due to the differing time horizons of the owner and operator (Beals, 1995; Beals & Denton, 2005). Operators, for example, are typically interested in achieving short-term cash flows, while hotel owners prefer the achievement of longer-term goals (Bridge & Haast, 2004; Guilding, Kennedy, & McManus, 2001; Lynch, 2002). This situation is known as the ‘horizon problem’ (Dechow & Sloan, 1991; Ittner, et al., 1997; B. Johnson, 1987; C. W. Smith & Watts, 1982). Operators also continually drive to increase the value of their brand and the longevity of their management contracts held so that they can secure good opportunities from new contracts and increase the number of rooms under their management (Beals & Denton, 2005; Haast, et al., 2006; Schiff, 2006). On the other hand, owners typically want to put their limited resources into projects that will maximise bottom-line returns (Beals & Denton, 2005; Haast, et al., 2006; Schiff, 2006). Management contracts therefore create incentives for the operator to shirk on their effort, which can cause monitoring costs to be high (Dimou, et al., 2003).

The extent of agency conflict between hotel owners and operators can also depend on whether the hotel owner is a “sleeping partner” or more active in the hotel’s day-to-day operations (Gannon & Johnson, 1997, p. 196). Gannon and Johnson (1997) explain that as owners become more involved in the operation of a hotel, it becomes more difficult for operators to act in a self-interested manner. The misalignment of time-based goals also becomes more pronounced should either the principal or agent consider terminating the relationship (Guilding, 2003). A further pertinent point is that courts in Western countries generally recognise the hotel owner and operator relationship as an agency relationship even if the management contract states otherwise (Renard & Motley, 2003). Table 3.2 serves to
outline the major differences between the interests of owners and operators within the hotel managerial contract arrangement.

**TABLE 3.2**
Interests of owners and operators under hotel management contracts

<table>
<thead>
<tr>
<th>Owner</th>
<th>Focus</th>
<th>Operators</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximise return and long-term asset value.</td>
<td>Objective</td>
<td>Maximise fee and retain asset under its long-term management control.</td>
</tr>
<tr>
<td>Derived from net income after debt service.</td>
<td>Return</td>
<td>Derived mainly from revenue and gross operating profit.</td>
</tr>
<tr>
<td>Decline in asset value (or total loss of investment).</td>
<td>Risk</td>
<td>Loss of income and reputation.</td>
</tr>
<tr>
<td>On refinancing or sale of asset.</td>
<td>Value</td>
<td>Addition to the brand and ability to further spread system overhead.</td>
</tr>
</tbody>
</table>

Source: Ransley and Ingram (2000, p. 47)

Due to the considerable agency issues arising from the use of hotel management contracts, an owner’s choice of operating company and the terms of the hotel management contract are among the most critical factors determining a hotel’s long-term success (Horwath, 2006). Getting this right, however, can be a time consuming and challenging task (Horwath, 2007). Nevertheless, it is imperative that owners bind operators to contracts that promote goal congruence so that both parties can ‘win’ (Armitstead & Marusic, 2006). To create a ‘win-win’ situation, Armitstead and Marusic (2006) suggest that hotel owners and operators consider a wide variety of issues in the negotiation of the management contract. These issues are outlined in Table 3.3.
### TABLE 3.3

<table>
<thead>
<tr>
<th>Stakeholder</th>
<th>Issues</th>
</tr>
</thead>
</table>
| **Owner**   | • Maximise the return on investment (ROI).  
              • Minimise level of risk.  
              • Ways of reducing possible risks.  
              • Future expectations for the ROI.  
              • Understanding the operation philosophy of the management company.  
              • Determine whether the operator understands the market where the project is planned to be developed. Is the operator familiar with the market?  
              • The location of where hotel/resort will be managed.  
              • Hotel operating company marketing programmes, i.e., not all hotel companies have good resort/conference expertise.  
              • Are the brand standards affordable?  
              • What type of guarantee is offered by the management company?  
              • Low base and high incentive fees from the operator.  
              • The brand name familiarity in the region and the brand’s image suitability.  
              • The market perception of the operator.  
              • The relationship between the owner and the operator.  
              • Termination of contract on sale. |

| **Operator** | • Length of contract.  
              • Base fees.  
              • Any guarantees.  
              • Incentive fees.  
              • Termination issues.  
              • FF&E reserve.  
              • Extent of owner’s obligation.  
              • Termination clauses and renewal.  
              • Whether the development will fit the company’s strategy and the existing portfolio.  
              • Whether the development will bring economies of scale in the long-run.  
              • The relationship between the operator and the owner.  
              • Impact on other ‘brand’ hotels.  
              • Ability to add value. |

Adapted from: Armitstead and Marusic (2006)

### 3.3 Conclusion

This chapter has reviewed several areas of the literature associated with different hotel operational structures. Regardless of who owns, and how the assets of a hotel are owned, hotels confront a number of choices regarding their operational structure (Hayes &
Ninemeier, 2004). The three most prominent methods of hotel operational structure internationally comprise: (1) the owner operator; (2) franchise; and (3) management contract (Gannon & Johnson, 1997). The choice between these three methods hinges on a wide array of factors, but it is becoming increasingly difficult for the owner-operator ownership structure to survive (Corgel, 2007a; Geller, 2002). A major difficulty in management contracts, however, is that they create significant agency issues due to the separation of ownership and management. As a result, it is important for owners to bind operators to contracts that promote goal congruence (Armitstead & Marusic, 2006). In order to gain a deeper appreciation of the agency issues that arise in a hotel management contracting context, the next chapter describes the nature of the main relationships existing between the five main stakeholder groups involved in a hotel management contract as well as the locus of power between hotel owners and operators.
CHAPTER 4
THE HOTEL MANAGEMENT CONTRACT STAKEHOLDER NETWORK

4.1 Introduction

This chapter serves to describe the nature of the main relationships existing between five key stakeholder groups involved in a hotel management contract, which include: (1) the hotel owner; (2) the hotel operator; (3) the general manager and financial controller; (4) the asset manager; and (5) bankers and lenders.

The remainder of this chapter is organised as follows. The first section provides a discussion and diagrammatic representation of the stakeholder network arising in the context of a hotel management contract. There appear to be three main principal-agent relationships arising in this context. Two further significant relationships will also be commented upon. The second section provides additional insight into the relationship between the owner and operator and how the locus of power between these two parties gives rise to significant agency issues. The third section investigates the unique relationship between general managers and financial controllers and the operator and owner. The fourth section looks at issues arising in the relationship between asset managers and owners. The fifth section considers the role of bankers and lenders in the management contract stakeholder network. The final section provides a concluding commentary for the chapter.

4.2 The hotel management contract stakeholder network

As explained by Guilding (2007), stakeholder concepts were first introduced by Barnard (1938). Since then, systems theorists (March & Simon, 1958) and corporate planners (Mason & Mitroff, 1981) have made considerable use of such concepts. Until Freeman (1984) integrated stakeholder concepts into a coherent construct, “stakeholderism” did not come to the wider attention of the academic community. Since then, much research (see e.g. Brenner & Cochran, 1991; Carroll, 1989; T. Donaldson & Preston, 1995; C. W. Hill & Jones, 1992; T. Jones, 1995; Woods, 1991) has extended Freeman’s (1984, p. 46) work, which has resulted in an increased recognition that stakeholder concepts have much to contribute to organisational research.
According to Freeman (1984, p. 46), a stakeholder is defined as “any group or individual who can affect or is affected by the achievement of an organisation’s objectives.” Further to this, stakeholders can be classified as primary or secondary stakeholders. According to Clarkson (1995, p. 106), a primary stakeholder is defined as:

One without whose continuing participation the corporation can not survive as a going concern. Primary stakeholder groups typically are comprised of shareholders and investors, employees, customers and suppliers, together with what is defined as the public stakeholder group: the governments and communities that provide infrastructures and markets, whose laws and regulations must be obeyed, and to whom taxes and other obligations may be due. There is a high level of interdependence between the corporation and its primary stakeholder groups.

Secondary stakeholders are not essential for a corporation to survive. As Guilding (2007, p. 4) notes, secondary stakeholders can:

… cause significant damage and may be opposed to the programs and policies that the corporation has adopted to fulfil its responsibilities or to satisfy the expectations and needs of its primary stakeholder groups.

Nowhere in the literature does there appear to be a comprehensive discussion of the main stakeholders involved in a hotel management contract. Accordingly, Figure 4.1 is believed to represent the first attempt to provide a diagrammatic representation of ‘The hotel management contract stakeholder network’. Significant relationships are highlighted through numbered lines that are solid or dotted. Solid lines are used to identify principal-agent relationships (i.e. primary stakeholders), while dotted lines highlight non-principal-agent relationships (i.e. secondary stakeholders). The line numbering facilitates identification of the relationships in the subsequent discussion. It is important to recognise that in the interests of parsimony the model presented does not represent an attempt to capture all permutations of the stakeholders involved in hotel management contracts. For example, Field (1995) has observed hotels being managed by two or more operating companies whereby one operator may manage the hotel’s accommodation and food and beverages, while the other operator might manage the sporting and health related activities. Within other studies of hotel management contracting (see e.g. Guilding, 2006), such structures were not encountered and have therefore not been included herein.
FIGURE 4.1
The hotel management contract stakeholder network

KEY:
- Principal-agent relationship (arrow points to agent)
- Non Principal-agent relationship
Relationship 1 is broken by the insertion of a box that highlights the intermediary nature of a hotel management contract in the fundamental relationship between a hotel owner (principal) and operator (agent). As noted in the previous chapter, much has been written about this particular agency relationship (see e.g. Beals, 1995; Eyster, 1997b; H. M. Field, 1995).

Relationship 2 highlights that it is usually the operator (principal) that engages the hotel’s general manager and financial controller (both agents) (Eyster, 1997b; Guilding, 2003, 2006; Rushmore, 2002).

Relationship 3 denotes the commonplace nature of the engagement of an asset manager (agent) by the hotel owner (principal). Asset managers are employed to monitor the operator (Armitstead, 2004; Swing, 2004). This engagement is designed to facilitate a productive alignment of interests between the owner and operator (Capital Hotel Management, 2006b; Feldman, 1995; Geller, 2002).

Relationship 4 highlights the non-principal-agent relationship between the hotel owner and the general manager / financial controller. In the majority of management contracts, the operator’s appointment of the general manager and financial controller requires the approval of the owner (Eyster, 1997a; Guilding, 2003; Haast, et al., 2005). There is evidence that hotel owners often pressurise operators to hire general managers of the same nationality as themselves to avoid any mismatches (Gannon & Johnson, 1997). There are, however, variations in the degree of the owners’ input to the general manager’s appointment, based on the terms of the hotel management contract (Gannon & Johnson, 1997). It is noteworthy that in some situations, the owner pays for the general manager’s expenses immediately (Dickson & Williams, 2006), while in other situations these expenses are initially paid for by the operator but are eventually reimbursed by the hotel owner (Eyster, 1997b; Guilding, 2003). In some management contracts, the owner also has the authority to remove the general manager for unacceptable performance (Crandell, Dickinson, & Kanter, 2004). As noted by Guilding (2006, p. 403):

This arrangement limits the legal obligations of the operator and appears to result from the need to facilitate easy transition when one operator is replaced by another. The fact that general managers and financial controllers are generally employees of the

---

1 “Asset management is the fiduciary responsibility of optimising the value of ownership’s lodging holdings” (P. J. Harris & Mongiello, 2006, p. 302).
operating company highlights their key placement with respect to mediating the relationship between hotel owner and operator.

Relationship 5 highlights the non-principal-agent relationship between the asset manager and the operator. There is significant information flow between these two stakeholders (especially from the operator to the asset manager). In some instances, however, the asset manager may be deprived of information that would enable them to make informed decisions about the operator’s work (Rainsford, 1994; Schlup, 2004). It is noteworthy that the owner’s use of an asset manager can promote a more hostile relationship between the owner and operator (Eyster, 1997a).

Relationships 6, 7 and 8 involve “bankers and lenders”, a stakeholder group that can be viewed as a secondary stakeholder given the focus of Figure 4.1, but a stakeholder grouping worthy of comment due to the pivotal importance of capital availability to the establishment and running of a hotel. Relationship 6 highlights the fact that one of the roles of an asset manager is to provide bankers and lenders with information necessary to facilitate lending decisions associated with capital outlays by the owner (Denton, 1998). Relationships 7 and 8 are also noteworthy because bankers and lenders appear to be assuming a more active role in their interactions with hotel owners and operators and are increasingly resorting to restrictive covenants when extending funds to owners and operators so as to minimise their potential exposure to bankruptcy and late repayment (Crandell, 2002; Denton, 1998; Wilder, 2004).

This section has introduced the main stakeholders involved in a hotel management contract. The following sections provide a more detailed insight into: (1) the relationship between the owner and operator; (2) the relationship between the general manager / financial controller and the operator as well as the owner; (3) the relationship between the owner and the asset manager; and (4) the role of bankers and lenders.

4.3 The relationship between the owner and operator

Relationship 1 in Figure 4.1 highlights the intermediary nature of a hotel management contract in the fundamental agency relationship between a hotel owner (principal) and operator (agent) (Beals, 1995; Eyster, 1997b; H. M. Field, 1995). This is important because hotel management contracts, like any contract, require some negotiation and only when there
is a balance between both the owner and operator will both parties be able to achieve their business goals over time (Armitstead, 2004). In a hotel capital budgeting context, for example, if the owner and operator have a good working relationship, major capital projects can be expected to be more successful (see e.g. Brander-Brown & Atkinson, 2001; Hassanien, 2006). As Goddard and Standish-Wilkinson (2002, p. 68) explain:

There are approximately 100 major negotiation points that need to be addressed in any management contract negotiation. The outcome of the negotiation of these 100 items will have an immediate and lasting effect on the value of the property, the cash flow likely to accrue to the owner and the performance and manageability of the operator.

A one-sided hotel management contract can therefore create conflicts that can result in lengthy and costly legal disputes or early termination of the management contract (Schlup, 2004). A perfectly balanced management contract, however, is really only a theoretical concept because in practice as there are so many factors (e.g. size of the hotel, location, total investment cost, structure of financing, market segment, size of chain and services offered by the operator) that impact on management contract negotiations signifying it would be too difficult to weigh up the advantages and disadvantages of every clause in a contract (Schlup, 2004). To try and achieve this balance, however, both the owner and operator should attempt to understand the main concerns of one another (Armitstead, 2004; Schlup, 2004).

Historically, in the 1970s, the locus of power in the negotiation of hotel management contracts favoured operators as a result of their superior industry knowledge and experience (Armitstead, 2004; Beals & Denton, 2005). As a result, operators could dictate favourable terms and levels of remuneration (Goddard & Standish-Wilkinson, 2002). In management contract situations, the owner provides all funding for the development of the hotel as well as all finance for working capital, pre-opening costs and would also absorb any losses (Armitstead, 2004). On the other hand, the role of the operator was limited to the provision of intellectual capital, a brand name and operation managers, sales and marketing support, and access to reservation, distribution and loyalty programs (Armitstead, 2004). This meant that the owner assumed a great deal of risk but very little risk was borne by the operator. During the 1970s, however, hotels were prosperous and hotel owners were not overly concerned about operators holding the locus of power due to the adequacy of owner returns on their investment (Beals & Denton, 2005).
By the 1990s the hotel management contract had undergone major changes, and owners began to gain the upper hand in contract negotiations (Eyster, 1993; W. Hart & Connor, 1994). One reason for this shift resulted from increased levels of competition among operators because more owners were looking to buy hotels than owners were willing to sell, which placed pressure on operators to offer more favourable terms to secure management contracts (Hanson, 2007). This led to a move away from fixed fees to more incentive based fees, shorter contract periods, a lower number of contract renewal options and more demanding performance clauses (Goddard & Standish-Wilkinson, 2002). To compete in this market, operators were forced to take on more contracts and/or offer equity and lower fees to owners in order to survive (Goddard & Standish-Wilkinson, 2002). A further reason for the shift was that hotel owners became more distinctly aware of the agency problems arising from the use of hotel management contracts (Armitstead, 2004; Beals & Denton, 2005).

Today, the shift in favour of the owner continues (Bader & Lababedi, 2007; Barge & Jacobs, 2001; Haast, et al., 2005; Horwath, 2007; Page, 2007; Property Council of Australia, 2003). There does remain a perception, however, that operators have more power in the relationship with owners because they control hotel operations and are experienced with hotels, while owners are said to lack control as a result of their distance from hotel operations (Property Council of Australia, 2003). Beals and Denton (2005), however, explain that the most turbulent period in the negotiation of management contracts has passed and, generally, most recently negotiated management contracts represent a reasonable approximation of a balance between the owner and operator. Recently in Europe, however, it has been said that the power balance is now slightly in favour of the owner (Bader & Lababedi, 2007). As Bader and Lababedi (2007) point out, the main reason for this is that there has been a large increase in the number of operators in Europe, which has placed further pressure on operators to offer more competitive terms to owners.

Table 4.1 presents the results of empirical investigations and normative commentaries with regard to management contract lengths. It shows that where operators held the locus of power in the 1970s and 1980s management contracts were relatively longer than has been the case in more recent times as owners have gained more power. This suggests that there is a negative relationship between hotel owner power and hotel management contract length.
<table>
<thead>
<tr>
<th>Study reference (and nature of study)</th>
<th>Time Period Investigated</th>
<th>Country/Region</th>
<th>Length in years</th>
<th>Number of renewal options</th>
<th>Length of renewal options in years</th>
<th>Renewal method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Horwath and Horwath (1988) (empirical investigation)</td>
<td>1970s-early 1980s</td>
<td>Australia</td>
<td>20-25</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Late 1980s</td>
<td></td>
<td>10</td>
<td>1</td>
<td>5-10</td>
<td>Dependent on achievement of certain conditions.</td>
</tr>
<tr>
<td>Sangree and Hathaway (1996) (empirical investigation)</td>
<td>1980s</td>
<td>U.S.</td>
<td>17</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>1990s</td>
<td></td>
<td>6</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>1990s</td>
<td></td>
<td>8-10</td>
<td>2-3</td>
<td>5</td>
<td>Subject to performance targets being met by the operator.</td>
</tr>
<tr>
<td></td>
<td>Forecast for 2000</td>
<td></td>
<td>5</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Johnson (1999) (normative commentary)</td>
<td>1997-1998</td>
<td>U.S.</td>
<td>12</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Barge and Jacobs (2001) (empirical investigation)</td>
<td>2001</td>
<td>Europe</td>
<td>19</td>
<td>2</td>
<td>5</td>
<td>(55% of contracts have option to renew)</td>
</tr>
<tr>
<td></td>
<td>Asia-Pacific</td>
<td></td>
<td>12</td>
<td>2</td>
<td>5</td>
<td>(80% of contracts have option to renew)</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td></td>
<td>10</td>
<td>Unlimited</td>
<td>5</td>
<td>(82.1% of contracts)</td>
</tr>
<tr>
<td>Study</td>
<td>Time Period</td>
<td>Region</td>
<td>Number of Years</td>
<td>No of Operators</td>
<td>No of Owners</td>
<td>Conditions</td>
</tr>
<tr>
<td>-----------------------------------------</td>
<td>-------------------</td>
<td>-----------------</td>
<td>-----------------</td>
<td>-----------------</td>
<td>--------------</td>
<td>------------</td>
</tr>
<tr>
<td>(normative commentary)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2000s</td>
<td></td>
<td>10</td>
<td>1</td>
<td>5</td>
<td>Stringent performance criteria must be met.</td>
</tr>
<tr>
<td>Guilding (2003)</td>
<td>2000s</td>
<td>Australia</td>
<td>5</td>
<td>1</td>
<td>5</td>
<td>Dependent on achievement of certain conditions.</td>
</tr>
<tr>
<td>(normative commentary)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Armitstead (2004)</td>
<td>1970s-1980s</td>
<td>U.S.</td>
<td>35-40</td>
<td>Yes but number not specified</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(normative commentary)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Haast, Dickson, and Braham (2005)</td>
<td>2005</td>
<td>U.S</td>
<td>13</td>
<td>1-2</td>
<td>5</td>
<td>By either a consensus of owner and operator or by operator meeting performance targets.</td>
</tr>
<tr>
<td>(empirical investigation)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Asia-Pacific</td>
<td>12</td>
<td>1-2</td>
<td>5-10</td>
<td>By either a consensus of owner and operator or by operator meeting performance targets.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Europe</td>
<td>15</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>(empirical investigation)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(normative commentary)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Although Table 4.1 suggests that greater owner power results in shorter management contracts, it is important to recognise that there are many older style management contracts (i.e. that were initially entered into for 50 years or more) still in use. This means that although the locus of power may be shifting toward the owner, the fixed nature of older style management contracts tends to ‘lock in’ the power balance at the time of contract negotiation. So in many cases, operators may still hold the upper hand until such contracts expire (Property Council of Australia, 2003). An interesting additional point on this issue is that Beals and Denton (2005) note that owners bound to such contracts do have (in the U.S.) legal precedents (such as Woolley v. Embassy Suites and 2660 Woodley Road v. ITT Sheraton) and other resources that they can turn to as a means to help protect their interests. In the Woolley and Woodley cases, for example, the courts ruled that even if the management contract says otherwise, hotel management companies are agents for the owner and must therefore act in the principal’s best interests (Renard & Motley, 2003). As a result of these court cases, the industry realised that the relationship between owners and operators was “much more than an arm’s length contractual arrangement” (Renard & Motley, 2003, p. 58). More specifically, Renard and Motley (2003, p. 58) explain that these court cases have led to the understanding that:

Agents owe their principals common-law fiduciary duties – specifically, the duties of loyalty, good faith, fair dealing, full disclosure, and due care. Agents must also eschew certain activities. They are obliged not to compete against their principals, not to engage in self dealing, not to take unauthorized and undisclosed profits, and not to use or appropriate the principal’s property (including the owner’s confidential information) without authorization to do so.

Within Australia, reasons for the relative increase in the locus of power of owners relative to operators is that there has been: (1) an increasing acquisition of hotels by well informed institutional investors who are increasingly employing, either internally or externally, their own dedicated hotel investment specialists, asset managers and legal counsel to represent their interests; (2) a greater concentration of hotel ownership; (3) a proliferation of hotel operators specialising purely in hotel management rather than hotel ownership; (4) a paradigm shift in operators from a ‘them and us’ mentality to a ‘we’re in this together’ approach; and (5) a realisation from operators that they must strive to meet the expectations

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3 Shindler (1997, p. 23) notes that in the U.S., these cases “extend[ed] the swing of the pendulum of bargaining power in the direction of the owner.”

4 Note that similar court cases do not appear to be present within the Australian legal system.
of owners in order to secure future hotel management contracts, especially given that the new supply of hotels is decreasing due to high construction costs (Bader & Lababedi, 2007; Beals & Denton, 2005; Colliers-International, 2007; Dickson & Williams, 2006; Haast, et al., 2006; Horwath, 2007). These points highlight that “owners are increasingly thinking beyond profit and loss and have become more involved in key decisions” (Bader & Lababedi, 2007, p. 178), which is seen as important because it can serve to maximise the value of hotel properties (Capital Hotel Management, 2006a). Areas in which owners have gained increased input include budgeting, the appointment of the general manager, the approval of major contracts with suppliers, and the approval of major changes in the concept of the hotel (Schlup, 2004). Owners have also gained considerable approval rights regarding certain aspects of the operation of their hotel (Rushmore, 2002). Some of the more important of these include: (1) expenditures for non-capital expenses (generally, those exceeding a specified level); (2) expenditures for capital items (generally, those exceeding a specified level); (3) plans to renovate the hotel; and (4) expenditures not covered in the annual budget (Rushmore, 2002).

The increased amount of ownership control, however, does not come without its own set of problems. Operators, for example, are complaining that if their management fee is contingent upon performance then, “shouldn’t they be given the right to manage the hotel free from the owner?” (Goddard & Standish-Wilkinson, 2002, p. 8). This issue appears to be of primary concern to operators because the most important reason for principals to exert influence over agents is so that they can obtain personal benefits (Kipnis, Schmidt, & Wilkinson, 1980). Owner interference, for example, has been shown to cause reduced operator incentive fees (Schlup, 2004). As a result, in recently negotiated management contracts, there appears to be an increasing trend in the use of ‘non-disturbance’ clauses, whereby owners assure the management company that they will not encumber or prevent the operator from doing the job for which they were engaged (Crandell, et al., 2004). A further concern from operators is that to enhance the value of their brand to its absolute maximum, they need full control of day-to-day operations (Schlup, 2004).
4.4 Relationship between general manager / financial controller and the operator and owner

Relationship 2 in Figure 4.1 highlights that because the operator (principal) employs the general manager / financial controller (both agents); a principal-agent relationship exists between these two parties. Relationship 4 in Figure 4.1 is highlighted because the operator’s appointment of the general manager and financial controller typically requires the approval of the owner (Eyster, 1997a; Guilding, 2003; Haast, et al., 2005). Therefore a non-principal-agent relationship exists between the hotel owner and the general manager / financial controller.

The employment arrangement of the general manager / financial controller, however, can cause conflicts because, although the operator has control over the general manager / financial controller, the owner also wants to have some influence in this relationship because they ultimately pay for managers’ salaries. A major problem, with particular regard to general managers (as opposed to financial controllers), is that general managers typically have career patterns that involve a high rate of mobility (Akrivos, Ladkin, & Reklitis, 2007; Ladkin & Riley, 1996; Riley & Ladkin, 1994). General Managers are typically transferred either within the same operating company (i.e. to higher levels) (Yeung, 2006) or to other operating companies (Swanljung, 1981). With this in mind, one could argue that general managers will be more likely to act in the operator’s interests as opposed to the owner’s interests because by doing so, this would give the general manager a better chance of gaining career promotion with either the same operating company or a different operating company. On the other hand, an opposing argument can be formed due to the fact that owner’s typically select the general manager (Eyster, 1997a; Guilding, 2003; Haast, et al., 2005). For this reason, general manager’s must be mindful to act in the owner’s interests when managing a hotel, or be faced with the prospect of not being selected by owners for general manager positions in the future when their current employment contract expires or is terminated. In this situation, it could be argued that general managers will be more likely to act in an owner’s interests as opposed to the operator’s interests to ensure future selection by owners for general manager positions. These two opposing arguments highlight that general managers are faced with incentives to act in both the owners’ and operators’ interests. The question therefore becomes, “In whose interests (i.e. the owner’s or the operator’s) will a general manager act?” Guilding (2006, p. 403) provides some insight to this important question as he notes that general managers are
strategically placed “with respect to mediating the relationship between hotel owner and operator”. This suggests general managers take a relatively balanced approach when acting in the relative interest of owners or operators. Guilding (2006, p. 405) comments:

… in hotels governed by a management contract, general managers … are generally employees of the operating company. This signifies that they are in a highly significant position in terms of exposure to potential … tensions arising between the two contracting parties. As they work for the operator, the general managers … can be expected to hold goals that may have some inconsistency with the hotel owner’s goals. As it is the owner who finances the purchase of any hotel asset and assumes the ultimate risk associated with ownership (i.e. potential decline in the asset’s value), it is the owner who represents the party with ultimate sanctioning authority in any … decision. For this reason, the general manager … can be seen to be well placed to observe any ‘cross-fire’ between a hotel owner and operator.

4.5 The relationship between owner and asset manager

Relationship 3 in Figure 4.1 highlights the principal-agent relationship between the owner (principal) and the asset manager (agent). The importance of this relationship is increasing nowadays as more hotel owners are choosing to engage an asset manager to closely monitor their hotel’s operations (Armitstead, 2004; Bader & Lababedi, 2007; Geller, 2002). This is largely because hotel owners are beginning to realise that hotel operators may not necessarily act in their best interests (Feldman, 1995).

The role of the asset manager generally has four dimensions. These comprise: (1) to act as a representative for the owner so as to achieve the owner’s goals and agendas; (2) to maximise the value of the owner’s asset through maximising return on investment; (3) to act as a facilitator for the owner; and (4) to oversee the operating company (Feldman, 1995). The level of involvement of the asset manager, however, often differs according to the specific needs of a particular owner (Jacobs, 2005).

Owners who use asset managers tend to realise higher returns than owners who are passive about the monitoring function (Beals, 2004). Without asset managers, for example, “it is almost certain than more monies will be spent [by the operator] than necessary” (Johnstone & Duni, 1995, p. 129). Operators, for example, agree that when there are asset managers overseeing their work, they must run a tighter ship (Feldman, 1995). This engagement, however, typically brings with it a potentially more hostile relationship between owner and operator (Eyster, 1997a). Many operators, for example, react to the presence of an asset
manager by creating an environment in which it is very difficult for the asset manager to understand what is going on, in order to keep the owner at bay (Feldman, 1995). It is therefore important that the asset manager cooperate and collaborate with the operator so that a non-hostile relationship can be developed (Capital Hotel Management, 2006a). This makes it vitally important that the owner chooses the right asset manager by making sure that they are qualified, capable, creative and cost-effective (International Society of Hospitality Consultants, 2007).

Although the employment of an asset manager is supposed to ensure a better alignment of the interests between the owner and operator (Bader & Lababedi, 2007), it is pertinent to note that asset managers are traditionally recruited from the ranks of hotel operating companies where they were previously employed as general managers or vice presidents (Bridge & Haast, 2004). Whilst in their previous role as an operator, it is said that their attention “would have been directed to short-term operational performance rather than long-term value enhancement” (Bridge & Haast, 2004, p. 252). Asset managers are therefore expected to carry over their operator like tendencies to their new role as an asset manager, which runs counter to the owner’s interests (Bridge & Haast, 2004). Feldman (1995) supports this position and highlights that asset managers are too often focused on their own goals as opposed to the owner’s goals. Examination of the typical remuneration basis for asset managers suggests, which is typically based on: (1) an hourly or daily rate; (2) a fixed dollar amount on a per-project basis; or (3) a fee structure linked to property value (Feldman, 1995), suggests that asset managers may support capital expenditure that falls short of an owner’s targeted rate of return. It therefore comes as little surprise that owners have expressed concern that they do not get value for money and are frequently dissatisfied with asset manager fee structures (Feldman, 1995). As a consequence, the effort to appropriately motivate the asset manager in the context of the management contract stakeholder network can be expected to continue to unfold (Beals, 2004).

### 4.6 The role of bankers and lenders in the management contract stakeholder network

Relationships 6, 7 and 8 in Figure 4.1 highlight that no principal-agent relationship exists between bankers and lenders and the other key stakeholders in a management contract. A discussion of this stakeholder group is, however, pertinent because bankers and lenders are increasingly specialising in making loans to the hotel industry and usually have significant
hotel industry experience (American Banker, 2000; Higley, 2005b). For this reason, hotel lenders can be expected to become involved in influencing the content, preparation and feasibility study analysis of capital expenditure projects because failure of such projects is typically attributed to a lack of specific expertise in the sector (Singh, et al., 2004).

Securing funding from bankers and lenders in the global hotel sector is also at an all time high (Elgonemy, 2002; Hiehaus, 2001). Despite this, “Hotels are considered one of the riskiest types of real estate to lend against” (Hochstein, 1999, p. 13). This is one reason why the bedrock of hotel real estate debt financing has typically come from commercial banks (Toman, 2006). Hotel lenders do, however, attach great importance to identifying “good hotels and people with a track record”, but hotel borrowers are forced to jump through more hoops than other types of borrowers (Hiehaus, 2001, p. 14). The situation is, however, beginning to improve for borrowers (W. Atkinson, 2005; Cruz, 2005; Higley, 2005a; Merkel, 2005; Watkins, 2005, 2006). One reason for this improvement is that loan-to-value ratios have improved between 2001 and 2005 (Hotel Brokers International, 2001, 2005). This has also resulted in a reduction in the number of technical defaults (Cruz, 2002; Hiehaus, 2001).

Operators have also benefited from the fact that most, if not all, hotel management contracts now incorporate a ‘lender non-disturbance agreement’, which is typically a tripartite agreement between the hotel operator, owner and the lender (Dickson, 2007; Dickson, et al., 2008). Under this agreement, if the owner goes bankrupt or defaults under its loan arrangement, the bank has a right to take control of the operation of the hotel (Dickson, 2007; Dickson, et al., 2008). This signifies that a non-disturbance agreement is an important document because it provides the hotel operator with a direct contractual relationship with the hotel owner’s bank (Dickson, 2007; Dickson, et al., 2008). This relationship can assist the operator to obtain the financier’s agreement to give the operator tenure (Dickson, 2007; Dickson, et al., 2008). In this way, the management contract survives.

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5 The loan-to-value ratio is a relationship, expressed as a percentage, of the amount of money loaned relative to the appraised value of the hotel pledged as security for the loan. As an example, an $85million loan on a $100million hotel would have a loan-to-value ratio of 85 per cent. The debt coverage ratio is the amount of cash flow available to meet annual interest and principal payments on debt. In general it is calculated by: Net Operating Income / Total debt service. As an example, a debt coverage ratio of 1.25 would mean that there is enough Net Operating Income to cover 125% of annual debt payments (Farlex, 2006).

6 Bankers and lenders are sometimes compassionate toward hotel borrowers that may be in technical default and grant concessions to avoid foreclosure. Such concessions, however, are typically only given to hotels that have strong future earning potential, such as four and five-star hotels located in city centres, due to their higher barriers to entry and greater market segmentation (Bartl & DiBenedetto, 2003).
In assessing which hotels to extend funds to, hotel lenders will also focus on the asset, the market, the operator and the investor to determine whether a hotel project shapes up to be ‘good’ (Bartl & DiBenedetto, 2003). With regard to the market, when the hotel market is in good times, lenders are more likely to accept a low profit and high risk and to be more aggressive in their provision of debt to the industry (Haast, et al., 2005). Hotel owners, operators, general managers and financial controllers, however, must understand that debt is only beneficial up to a point, and given the volatility of the earnings of hotels, it is prudent to thoroughly investigate the feasibility of any financing strategy (Elgonemy, 2002).

Hotel owners who engage asset managers can also receive preferential treatment from bankers and lenders because investment risk is seen as being lower (Jacobs, 2005). Another important element that bankers and lenders assess prior to the provision of debt finance is the appropriateness of a hotel’s brand and the effectiveness of the operator (Bartl & DiBenedetto, 2003). In addition, the type of lender attracted to a particular hotel can be associated with a number of hotel specific factors, such as its: (1) pricing category; (2) function; (3) location; and (4) market served (Singh & Schmidgall, 2000). Recently there has been evidence that lenders are favouring the extension of credit to new hotel developments, rather than refurbishing existing hotels, as the price of existing assets continues to soar around the world (Wood, 2007). This tendency will only last as long as the hotel industry shows growth, however, and growth could have already hit a plateau (Swig, 2007).

Where difficulty is experienced in securing funding, hotel owners generally adopt two approaches. Either they defer maintenance expenditure, or they sell their hotel property altogether (Haast, et al., 2004). Where the former approach is adopted, it can lead to further physical deterioration of a hotel property, as well as a build up of future capital expenditure requirements (Margolis, 1981). Another outcome of the difficulty in securing funding, particularly in hotels that have borrowed heavily, is that more hotel owners can enter into joint ventures in order to raise additional capital, but this is generally a much more costly source of finance (Elgonemy, 2002).

4.7 Conclusion

This chapter has highlighted the main relationships in the hotel management contract stakeholder network. It is important to recognise that, in the interests of parsimony, the model
presented did not represent an attempt to capture all permutations of the stakeholders involved in hotel management contracts. Indeed, a fairly liberal view has been taken with respect to what parties comprise this network. This has resulted in consideration being given to the role of bankers and lenders. Appraising this role appears warranted given the impact that restrictive loan covenants can have on some of the other stakeholders’ activities. The next chapter provides a review of the management accounting capital budgeting literature that is most pertinent to this thesis.
CHAPTER 5
THE MANAGEMENT ACCOUNTING CAPITAL BUDGETING LITERATURE

5.1 Introduction

The depth and breadth of prior studies that have investigated the nature and context of capital budgeting appraisal activity is apparent from Dempsey’s (2003) review of the advancement of capital budgeting appraisal research (Guilding, 2006). Dempsey classifies this research into three categories: finance capital budgeting research, strategic management capital budgeting research and management accounting capital budgeting research. The finance perspective takes an economic theoretical orientation and research in the area is typically highly mathematical and concentrated on areas such as capital asset pricing (S. Ross, 1978) and real options theory (Cortazar & Casassus, 1998; Pinches, 1998). The strategic management perspective typically focuses on strategy development and application (see e.g. Porter, 1985; Seal, 2001). The management accounting perspective has traditionally focused on qualitative case analyses that seek to gain a deeper understanding of contextual and procedural issues associated with capital budgeting (Carr & Tomkins, 1998; Slagmulder, 1997).

Due to size and scope limitations and the management accounting orientation of this thesis, the objective of this chapter is to provide an overview of the management accounting capital budgeting literature. The remainder of this chapter is organised as follows. The first section outlines the nature of capital budgeting projects. Following this, an outline of the use of quantitative capital budgeting appraisal techniques is provided. After this, a review of the use of qualitative capital budgeting appraisal techniques is presented. Next, an investigation of the capital budgeting proposal biasing literature is given. The final section provides a concluding commentary for the chapter.

5.2 The nature of capital budgeting projects

Capital budgeting projects can be distinguished from recurrent expenditures (e.g. repair and maintenance expenditures) by two features, which include that the project be significantly large and that the project be long-lived with it’s benefits spread out over many years (Dayananda, Irons, Harrison, Herbohn, & Rowland, 2002). In this way, capital budgeting is
said to be “the process of planning for purchases of assets whose returns are expected to continue beyond 1 year” (Moyer, McGuigan, & Kretlow, 2001, p. 300). Capital budgeting is therefore a vital activity which can define the productive identity of a firm (Arya, Fellingham, & Glover, 1998). Indeed, a firm’s success or survival often hinges on the capital budgeting decision (Demski, 1997). Haka (2007) notes that capital budgeting decisions require sizable cash outlays and have a long-term impact on the future profitability of a firm.

To assist in the capital budgeting decision-making process, quantitative and/or qualitative capital budgeting appraisal techniques are often used (Moyer, et al., 2001). Although there has been a substantial focus within the literature on the use of different quantitative capital budgeting appraisal techniques (see e.g. Kester, et al., 1999; Lamminmaki, Guilding, & Pike, 1996; Pike, 1996), there has been only some research attention devoted to the relative importance of qualitative factors in investment appraisal (see e.g. Butler, Davis, Pike, & Sharp, 1993; Guilding, 2006; Van Cauwenbergh, Durinck, Martens, Laveren, & Bogaert, 1996). Despite the paucity of research concerning qualitative capital budgeting appraisal techniques, the relative mix of quantitative and qualitative techniques used is typically made in accordance with the relative scale, risk and type of capital budgeting project under consideration (Burns & Walker, 1997; Hayes & Abernathy, 1980; Hayes & Garvin, 1982; Hill, 1985; S. Ross, 1995; Steinbruner, 1974). In some situations, for example, there is strong evidence to suggest that human judgment (i.e. a qualitative technique) is the overarching choice of managers in making the capital budgeting decision because quantitative techniques sometimes lack transparency (see Dayananda, et al., 2002). Regardless of the degree of quantitative analysis adopted, however, some qualitative analysis is typically conducted (Kamath & Oberst, 1992). The next two sections outline the use of quantitative and qualitative capital budgeting appraisal techniques.

5.3 Quantitative capital budgeting appraisal techniques

A large portion of the management accounting capital budgeting literature has documented the findings of surveys of capital budgeting practice, which include investigations conducted in the U.S. (see Gurnani, 1984; D. F. Scott & J. Petty, 1984), Canada (see Payne, Carrington-Heath, & Gale, 1999), the U.K. (see Pike, 1996; Sangster, 1993), New Zealand (see Lamminmaki, et al., 1996) and Australia (see Guilding & Lamminmaki, 2007; McMahon, 1981). Research has also been carried out regarding the optimal adoption of capital budgeting
appraisal techniques in single division firms (see Berkovitch & Israel, 2004; Bernardo, Cai, & Luo, 2001; Garcia, 2001, 2002) and multidivisional firms (see Antle & Eppen, 1985; Rajan, Servaes, & Zingales, 2000). Although other capital budgeting appraisal techniques have been commonly used, such as return on investment (ROI) and profitability index (PI) (Hubbard & Bullard, 1982; Replogle, 1986), Guilding and Lamminmaki (2007) note that within the aforementioned studies, payback, average accounting rate of return (AARR), net present value (NPV), and internal rate of return (IRR) are the four most widely appraised quantitative methods of capital budgeting practice (Damitio & Schmidgall, 2002; Lamminmaki, et al., 1996; Payne, et al., 1999; Pike, 1996 also make similar comments).\footnote{AARR is effectively a projected average annual return on investment (ROI) for an individual project (Langfield-Smith, Thorne, & Hilton, 2000).} Table 5.1 provides an overview of the criteria for acceptance of a project and the strengths and weaknesses of each of these four commonly used quantitative capital budgeting methods.
<table>
<thead>
<tr>
<th>Model</th>
<th>Project acceptance criterion</th>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net present value (NPV)</td>
<td>Accept project if it has a positive or zero NPV; that is, if the present value of net cash flows, evaluated at the firm’s cost of capital, equals or exceeds the net investment required.</td>
<td>Considers the timing of cash flows. Provides an objective, return-based criterion for acceptance or rejection. Most conceptually correct approach.</td>
<td>Difficulty in working with an absolute dollar return value, rather than percentage returns.</td>
</tr>
<tr>
<td>Internal rate of return (IRR)</td>
<td>Accept project if IRR exceeds the firm’s cost of capital.</td>
<td>Same benefits as the NPV. Easy to interpret the meaning of IRR.</td>
<td>Multiple rates of return problem. Sometimes gives decision that conflicts with NPV.</td>
</tr>
<tr>
<td>Payback period</td>
<td>PB should not be used in deciding whether to accept or reject an investment project.</td>
<td>Easy and inexpensive to use. Provides a crude measure of project risk. Provides a measure of project liquidity.</td>
<td>No objective decision criterion. Fails to consider timing of cash flows.</td>
</tr>
<tr>
<td>Average accounting rate of return (AARR)</td>
<td>Accept project if AARR is equal to or greater than the firm’s cost of capital.</td>
<td>Simple way of screening projects. Consistent with financial accounting statements, which are also based on accrual accounting. Consistent with profit-based performance evaluation systems. Considers the entire life of the project.</td>
<td>Does not consider the time value of money.</td>
</tr>
</tbody>
</table>

Adapted from: Moyer et al. (2001, p. 352) and Langfield-Smith et al. (2000, pp. 18.18-18.20)
The relative usage of the four most widely appraised methods of capital budgeting practice outlined by Guilding and Lamminmaki (2007) can also vary on a country by country basis. Table 5.2, for example, highlights the relative usage of the four most widely appraised methods of capital budgeting practice within the Asia-Pacific region.

<table>
<thead>
<tr>
<th>Evaluation Technique</th>
<th>Australia</th>
<th>Hong Kong</th>
<th>Indonesia</th>
<th>Malaysia</th>
<th>Philippines</th>
<th>Singapore</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal rate of return (IRR)</td>
<td>96%</td>
<td>86%</td>
<td>94%</td>
<td>89%</td>
<td>94%</td>
<td>88%</td>
</tr>
<tr>
<td>Net present value (NPV)</td>
<td>96%</td>
<td>88%</td>
<td>94%</td>
<td>91%</td>
<td>81%</td>
<td>86%</td>
</tr>
<tr>
<td>Payback period</td>
<td>93%</td>
<td>100%</td>
<td>81%</td>
<td>94%</td>
<td>100%</td>
<td>98%</td>
</tr>
<tr>
<td>Accounting rate of return (AARR)</td>
<td>73%</td>
<td>80%</td>
<td>56%</td>
<td>69%</td>
<td>78%</td>
<td>80%</td>
</tr>
</tbody>
</table>

Adapted from: Kester et al. (1999, p. 28)

Despite the widespread use of quantitative capital budgeting appraisal techniques, they can, however, lead to the ultimate decline of a firm (Hayes & Abernathy, 1980; Hayes & Garvin, 1982). In addition, their use does not necessarily translate into better firm performance in the market place (Baldwin & Clark, 1994; Cooper & Petry, 1994; Haka, Friedman, & Jones, 1986; Haka, Gordon, & Pinches, 1985; Jensen, 1993; Johnson, 1994; Klammer, 1973). A successful capital budgeting project, for example, does not necessarily have to be justifiable on purely quantitative grounds (Carr, Tomkins, & Bayliss, 1994; Hill, 1985; Liberatore, Monahan, & Stout, 1992; Mito, 1991; Peters & Waterman, 1982). Indeed, reliance on quantitative capital budgeting appraisal techniques alone can lead to the adoption of uneconomically viable projects (Brockner, Shaw, & Rubin, 1979; Cheng, Schulz, Luckett, & Booth, 2003; Chow, Harrison, Lindquist, & Wu, 1997; Harrell & Harrison, 1994; Northcraft & Neale, 1986).

Payback and AARR are considered to be simple, while NPV and IRR, which are known as discounted cash flow (DCF) techniques, are regarded as being sophisticated due to the greater complexity involved in the calculation of cash flows (Ballantine & Stray, 1999; Butler, et al., 1993; Haka, et al., 1985; Klammer, 1972; Pike, 1983). Haka (2007) explains that there has been a steady increase in the use of sophisticated capital budgeting appraisal techniques since

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2 ROI is considered simple due to its disincentive effects on capital investment (see e.g. Dearden, 1960, 1962, 1968, 1969; Mauriel & Anthony, 1966; Porter, 1992; Yates & Tinius, 1998).
the 1950s as they are often viewed as being better able to provide for a more appropriate appraisal of capital investment (Gitman & Forrester, 1977; Petty, Scott, & Bird, 1975; D. F. Scott & F. W. Petty, 1984). The environment, however, may not have enough predictability and certainty for the sophisticated techniques to work efficiently (Chen, 1995; Grundy & Johnson, 1993; Haka, 1987; Mouck, 2000). Sophisticated capital budgeting appraisal techniques, for example, can typically only be used when there is quantifiable past information available regarding the values being forecasted (Dayananda, et al., 2002). Managers must also typically assign risk premiums subjectively or based upon sensitivity analysis (Shao, 1994). The significant amount of subjectivity in calculating inputs to sophisticated capital budgeting appraisal techniques can then lead to managerial self-serving bias (Miller, 1978; Tole, Hand, & McCord, 1997). Such bias can increase the amount of information corruption (Marino & Matsusaka, 2005). Use of sophisticated capital budgeting appraisal techniques can also create high information costs of explaining the meaning and implications of a more complex model (e.g. NPV) as compared to a simple model (e.g. payback) (Collier & Gregory, 1995). These factors have led many researchers to question whether sophisticated capital budgeting appraisal techniques are practicable (Adelson, 1970; Butler, et al., 1993; Cooper, 1975; Haynes & Solomon, 1962; King, 1975).

A further important factor in the determination of the type of quantitative factors used in the capital budgeting decision-making process is company size, which is positively related to quantitative capital budgeting technique sophistication (Block, 1997; Danielson & Scott, 2006; Graham & Harvey, 2001; Guilding & Lamminmaki, 2007; Kocher, 2007; Lamminmaki, et al., 1996; Patterson, 1989; Pike, 1996; Smith & Wynne, 2006). Danielson and Scott (2006) also found that smaller organisations are likely to make greater use of simple quantitative capital budgeting appraisal techniques.

Whether an organisation is publicly traded or privately traded can also influence the type of quantitative capital budgeting appraisal techniques adopted. In publicly traded firms, for example, sophisticated capital budgeting appraisal techniques tend to dominate (Farragher, 1986; Kim & Farragher, 1981; Pike, 1985). This is despite the fact that there is evidence that simple quantitative capital budgeting appraisal techniques, such as payback, can be just as effective in promoting shareholder wealth maximisation as sophisticated capital budgeting appraisal techniques (Statman & Sepe, 1984). On the other hand, private unlisted firms tend to make relatively low use of sophisticated capital budgeting appraisal techniques (Holmes &
Nicholls, 1988). A potential reason for this is that justification for the discount rates used in sophisticated capital budgeting appraisal techniques are based on the separation principle (i.e. that capital budgeting decisions can be made independent of shareholders’ preferences), which does not always hold for closely-held smaller private firms (McInish & Kudla, 1981).

The management style of the principal can also affect the relative sophistication of the quantitative capital budgeting appraisal techniques used. A ‘hands on’ approach, for example, which is described as the situation in which the principal can exercise a dominant position or leadership over the agent, is typically accompanied by use of simple capital budgeting appraisal techniques (Collier & Gregory, 1995). A potential reason given for this is that many capital budgeting decisions are often “fairly standard … with a considerable bank of past experience to draw upon” (Collier & Gregory, 1995, p. 53). In this way, “It may therefore be the case that the application of a simple heuristic could be capable of estimating the likely success of a venture without recourse to complex methods of investment appraisal” (Collier & Gregory, 1995, p. 53). As a result, it can be more cost-effective to make use of simple, as opposed to sophisticated, capital budgeting appraisal techniques (Collier & Gregory, 1995; Scapens, 1984, 1991).

5.4 Qualitative capital budgeting appraisal techniques

Although the traditional emphasis of capital budgeting research has focused on quantitative techniques in the preparation of capital budgeting proposals (Farazmand & Neill, 1996), as the usefulness of quantitative capital budgeting appraisal techniques becomes more questionable (Langley, 1990, 1991), it is now generally accepted that the astute financial manager should consider both quantitative and qualitative factors in the capital budgeting decision (Butler, et al., 1993; Dayananda, et al., 2002; Marino & Matsusaka, 2005; Pohlman, Santiago, & Markel, 1988; Van-Cauwenbergh, Durinck, Martens, Laveren, & Bogaert, 1996). Quantitative capital budgeting appraisal techniques, for example, fail to incorporate a multitude of important qualitative factors involved in the justification of capital budgeting decisions (Mohanty & Deshmukh, 1998). Smaller organisations, however, are more likely than large organisations to apply a greater use of qualitative techniques, such as an owner’s gut-feel (Danielson & Scott, 2006). A potential reason for the increased use of qualitative techniques in smaller firms is that their owners generally have limited educational backgrounds (Danielson & Scott, 2006). To further appreciate qualitative capital budgeting
appraisal techniques, Butler et al. (1993) group them into three categories: (1) strategic factors; (2) risk factors; and (3) performance factors. The following three sections describe each of these categories.

5.4.1 Strategic factors

Strategic factors are the most important qualitative consideration in the evaluation of capital budgeting proposals (Alkaraan & Northcott, 2007; Butler, 1991; Grundy & Johnson, 1993; Mohanty & Deshmukh, 1998) because quantitative capital budgeting appraisal techniques often fail to capture many of the strategic benefits that can be derived from capital budgeting projects (Drury & Tayles, 1995; Lefley & Sarkis, 1997; Naik & Chakravarty, 1992). Lefley (2004, p. 851), for example, explains that:

 Managers are placed in a dilemma in that, on the one hand, they wish to invest in projects that may have high strategic implications, but, on the other hand, they find it difficult to justify the capital expenditure for such projects using the traditional financial appraisal techniques … there is without doubt a need for a broader approach to the appraisal of capital projects, one that considers not only the financial aspects of an investment decision but also the strategic nature of each investment.

Given the importance of strategic factors to the preparation of capital budgeting proposals (see also Carr & Tomkins, 1996; Marsh, Barwise, Thomas, & Wensley, 1988; Shank, 1996), Butler et al. (1993) explain that to include such factors into investment appraisal, managers must consider: (1) the degree of fit of the capital budgeting project with business strategy; (2) how the project will affect the growth rate of markets related to the project; (3) how the project will affect the competitive position of the company/unit in comparison to external competition; and (4) how the project will affect the performance of the company/unit. In this way, strategic factors are essentially concerned with ensuring that capital budgeting projects deliver a ‘competitive advantage’ to the firm (Emblemsvag & Endre Kjolstad, 2002; Lefley, 2004; Lefley & Sarkis, 1997; Proctor & Canada, 1992).

The importance of qualitative strategic analysis in the preparation of capital budgeting proposals increases relative to the use of quantitative capital budgeting appraisal techniques as the “relative urgency for competitive or other reasons” increases (Ackerman, 1970, p. 348). Adler (2000, p. 15) also comments that:

… [managerial use of qualitative strategic factors involves] selecting among projects that are likely to have a big impact on a company’s competitive advantage. More
specifically, the decision will influence what the company does (the set of product and service attributes that define its offerings), where it does it (the structural characteristics that determine the scope and geographical dispersion of its operations), and how it does it (the set of operating processes and work practices it uses).

To ensure that a capital budgeting project does deliver competitive advantage, Emblemsvag and Endre Kjolstad (2002) explain that managers often cross-link the characteristics of risks and strategy to carry out a ‘strengths, weaknesses, opportunities and threats’ (SWOT) analysis.

5.4.2 Risk factors

Butler et al. (1993) explain that in their consideration of ‘risk factors’, managers must think about: (1) the sensitivity of the project to internal and external economic changes; (2) the type of project (e.g. replacement, cost-saving, new technology etc.); (3) the impact on the financial position of the organisation if the project failed; (4) the investment track record of the sponsor (i.e., the individual who has proposed the project); (5) the impact of the project on the career and / or earnings of the sponsor; and (6) the level of agreement (opposition) from interested parties. In this way, Butler et al. (1993) explain that qualitative risk factors are essentially concerned with ‘political activity’. Guilding (2006, p. 410) makes further comment about political models of decision-making:

Political models of decision making view organizations as a coalescence of potentially competing, self-interested individuals employing guile and strategies, such as coalition building, in the pursuit of their own personal ends (Hickson, Butler, Cray, Mallory, & Wilson, 1986; Pfeffer, 1981).

The way in which political activity could impact on a capital budgeting project is evident by considering, for example, the reliability of a project’s sponsor, which might be the key reason for an organisation’s adoption of a capital budgeting project as opposed to that decision being based upon quantitative criteria (Ackerman, 1970). Another example could be where a project’s sponsor enters into a coalition or alliance with another group or individual in order to get their preferred project(s) accepted (Cyert & March, 1963). Political activity can therefore give rise to investment choices that would never be justified on purely economic grounds (Butler, et al., 1993). For this reason, political factors are important in evaluating capital budgeting proposals (Astley, Axelsson, Butler, Hickson, & Wilson, 1982).
5.4.3 Performance factors

Due to the lack of objectivity in performance factors, studies (see e.g. Berry, 1984; Bower, 1970; Lumijarvai, 1991; Marsh, et al., 1988) focusing on this aspect of the capital budgeting decision making process have often been criticised (see e.g. Barnea, Haugen, & Senbet, 1981; Crum & Derkinderen, 1981; Jones, 1984; Pinches, 1982). Nevertheless, Butler et al. (1993) explain that in their consideration of ‘qualitative performance factors’, managers must think about: (1) the effect of the project on product quality; (2) the effect of the project on the morale of the personnel of the organisation; (3) the effect of the project on industrial relations; and (4) the way in which the project can contribute to corporate image. In this way, qualitative performance factors typically comprise a ‘human element’, such as intuition and/or judgement (see Chami & Fullenkamp, 2002; Dempsey, 1996; Guilding & Lamminmaki, 2007; Kay, 1993; Maccarrone, 1996; Moncarz & Kron, 1995; Mukherji & Nagarajan, 1995; Tinsley, O'Connor, & Sullivan, 2002; Van Cauwenbergh, et al., 1996). Although a project may have a negative NPV, for example, such projects are often accepted based on intuition alone (Lefley, 2004). The concepts of intuition and judgement, however, are inextricably linked because where a manager has used intuition as part of the capital budgeting decision-making process, it is often difficult to explicate fully the reasons for their judgement (Butler, et al., 1993). Managers typically gather information from a variety of sources, particularly informal sources, to form their solutions (Eisenberg, 1984; Issack, 1978; Simon, 1987). Overall, consideration of performance factors is viewed as highly important in the capital budgeting decision-making process (Alkaraan & Northcott, 2007; Donaldson & Lorsch, 1983; Van Cauwenbergh, et al., 1996).

5.5 Biasing of capital budgeting proposals

Biasing of capital budgeting proposals has its foundations with asymmetric information, where the agency model is central (Bohlin, 1997). Information asymmetry and systematic differences in the time horizons of principals and agents, for example, can motivate agents to bias capital budgeting proposals toward projects with high short-term payoffs so as to benefit

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3 Van Cauwenbergh, Durinck, Martens, Laveren and Bogaert (1996, p. 170) see intuition as “A well-aimed sensing of what the future will bring in a particular context”. Intuition is therefore built on relevant experience in that particular context. In Mares (1991, p. 57), intuition is seen as a “premonition”. Agor (1986, p. 6) defines intuition as “a product of both factual and feeling cues”.

their self-interest at the expense of the longer-term goals of the principal (Arya, et al., 1998; Bower, 1986; Chaney & Lewis, 1995; Haka, 2007; Kida, Moreno, & Smith, 2001; Moreno, Kida, & Smith, 2002; Moyer, et al., 2001; Mukherjee & Henderson, 1987; Pinches, 1982; Reimann, 1990; Ruhl & Cowen, 1992; Rutledge & Karim, 1999; Staw, 1976; Welker, 1995; Zhang, 1997). A general manager, for example, only “sponsors a project when he believes it will be in his interest to do so rather than not to do so, given his understanding of ‘the rules of the game’” (Bower, 1970, p. 59). An early study by Berg (1965) gave an insight into what ‘the rules of the game’ might be by identifying that managers tended to have short-term time horizons and high discount rates.

The managerial mentality to prepare capital budgeting proposals in self-interest can therefore lead to ‘empire building’, whereby a manager selectively positively biases capital budgeting projects that will stimulate their sense of importance within the firm (Harris & Raviv, 1996, 1998). Positive NPV projects, for example, will not advance if the manager does not sponsor them (Bower, 1970). Further to this, where there is a lot of ‘free cash’ available, managers faced with only negative NPV projects will squander resources by positively biasing and taking on these projects (Jensen, 1986). The propensity for such biasing is also heightened where the manager is inefficient and performing poorly (Ghosh & Sirmans, 2006). Organisations try to counter such counterproductive managerial behaviour by paying out higher dividends when there are limited positive NPV projects available, so as to prevent over-investment by self-interested managers (Ghosh & Sirmans, 2006). Another strategy is for details of any variations above pre-determined budgetary limits to be provided by the manager (Bower, 1986; Mukherjee & Henderson, 1987). At the same time, however, the motivation to negatively bias capital budgeting proposals can be explained by drawing on the rationale espoused in the budgetary slack literature. Budgetary slack arises where a manager deliberately inflates budgetary expense figures or deflates budgeted sales or profit figures to make a budgetary target easier to attain so that their performance appears better than it actually is (Dunk, 1993; Lukka, 1988; Waller, 1988). Budgetary slack increases as agents are given a greater ability to participate in budget setting (Collins & Manion, 1994; Dunk & Perera, 1997; Fisher, Frederickson, & Peffer, 2000). Budgetary slack can also increase as the level of information asymmetry between the principal and agent increases (Baiman & Lewis, 1989; Baiman & Sivaramakrishnan, 1991; Waller, 1988).
Although long-term contracts, can assist in mitigating the information asymmetry problem (Antle & Fellingham, 1990; Haka, 1987; Larker, 1983), contracting between principals and agents can also create incentives for an agent to under-invest in the principal’s investment (Hart & Moore, 1988; Williamson, 1985). Principals, for example, do not have access to the costless private information of the manager (Cremer & Khalil, 1992, 1994; Cremer, Khalil, & Rochet, 1998). For this reason, principals often craft their own normative rules with regard to how capital budgeting ideas are formally generated, analysed and evaluated (Simonson & Staw, 1992). Despite such guidelines, however, there is substantial anecdotal evidence that suggests that capital budgeting proposals often deviate from these guidelines (Kadous & Sedor, 2004). Indeed, the extent to which agents are likely to engage in self-interested biasing has been shown to depend on a range of factors such as: (1) the manager’s knowledge; (2) risk profile; (3) ability; (4) aversion to effort; (5) compensation; and (6) reputation (Haka, 2007).

Although the likelihood of managers engaging in self-interested biasing is likely to vary based upon personal characteristics, managers typically face a number of motivations to do so. One such motivation can be fuelled by the degree of centralisation or delegation of the capital budgeting proposal development function within an organisation, which is essentially connected with the degree of owner participation in the preparation of capital budgeting proposals (Chandler, 1977; Dulman, 1989; Dutta, 2003). By becoming more involved in the preparation of capital budgeting proposals, for example, the owner is typically better positioned to reduce the amount of asymmetric information and therefore to reduce the information advantage that their manager has over them (Antle, Bogetoft, & Stark, 1999). In centralised capital budgeting settings, for example, the owner keeps a hand in the decision and approves all capital budgeting projects and also requires that a certain rate of return be achieved for a project to get the go ahead (Antle, et al., 1999; Horngren, Foster, & Datar, 2000). As a result, there is often a much stronger positive relationship between earnings and capital investment than in delegated investment settings (Sunder, 1980).

Within delegated investment settings, the owner provides capital budgeting decision-making power to the agent. Typically, some mix of these orientations is evident (Marino & Matsusaka, 2005). Delegation, however, usually allows the agent to overspend, whereas,

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4 In some centralised organisations owner approval may only be necessary once a project goes over a pre-specified monetary threshold (see Marshuetz, 1985; M. Ross, 1986).
centralisation gives the agent incentives to positively bias capital budgeting proposals toward their preferred projects so that these projects have a greater chance of owner acceptance (Marino & Matsusaka, 2005). Agents in centralised settings, however, can be demotivated by the heightened propensity of the owner to overrule their investment decisions and are therefore more likely to reduce their information-collection effort (Marino & Matsusaka, 2005).

When markets are performing strongly, managers are generally more inclined to indulge in self-serving capital budgeting behaviour than in bad times (Ho, Keller, & Keltyka, 2005). It must be recognised, however, that by becoming more involved in the preparation of capital budgeting proposals, the owner usually has to incur higher monitoring costs (Harris & Raviv, 1996). Many owners, however, do not have the time to observe all the decisions and actions of agents (Statman, 1982). A further potential problem associated with owners monitoring agents is that agents may negatively bias cash inflow estimates where the owner monitors the manager’s performance based on outputs rather than behaviour (Sharma, 1997).

The size of an organisation can also influence an owner’s concern regarding a manager’s tendency to bias capital budgeting proposals. Managers in smaller but growing firms, for example, are more likely to understate the true potential of projects and therefore under-invest (Danielson & Scott, 2007). On the other hand, in larger organisations with many owners, managers have a tendency to overstate the true potential of projects and therefore over-invest (Danielson & Scott, 2007). It is also the case that the potential for optimistic data biasing in capital budgeting proposals can be heightened where principals exercise tight capital rationing regimes (Antle & Eppen, 1985; Hirshleifer, 1993; Holmstrom & Costa, 1986; Mukherjee & Hingorani, 1999).

To improve the likelihood of detecting and preventing managers’ biases, organisations often engage independent reviewers to promote the acceptance of only those projects that will be viable and profitable from the owner’s point of view (J. Ross & Staw, 1993; Rutledge & Harrell, 1994; Schulz & Cheng, 2002). Theoretically, such a step should mean that owner wealth will be maximised as a result of managers being forced to reasonably estimate total cash inflows and cash outflows while taking into consideration income tax implications, the required rate of return, inflation and project risk (Berry, 1984; Horngren, et al., 2000). It is not uncommon to see capital budgeting proposals having to pass through several layers of
independent reviews in order to obtain formal approval from the owner (Bromiley, 1986; Segelod, 1997). The use of independent reviews, however, does not result in bias free proposals because the reviewer imparts their own biases on the capital budgeting proposal (Cheng & Mahama, 2007; Kadous, Koonce, & Towry, 2005). In addition, there is evidence that reviewers can often perceive managers as being less ethical than they actually are which can further complicate matters (Epley & Dunning, 2000; Heath, 1999; Thomas, 1990).

5.6 Conclusion

This chapter has provided an overview of the management accounting capital budgeting literature. It has been shown that capital budgeting projects can be distinguished from recurrent expenditures (e.g. repair and maintenance expenditures) as capital expenditures are large and concern long-lived projects (Dayananda, et al., 2002). Due to the importance of the capital expenditure, a firm’s success or survival often hinges on appropriate capital budgeting decision making (Demsiki, 1997).

To assist in the capital budgeting decision-making process, a combination of quantitative and/or qualitative capital budgeting appraisal techniques are often used (Kamath & Oberst, 1992; Moyer, et al., 2001). With regard to quantitative capital budgeting appraisal techniques, Guilding and Lamminmaki (2007) noted that payback, average accounting rate of return (AARR), net present value (NPV), and internal rate of return (IRR) are the four most widely appraised quantitative capital budgeting appraisal techniques. Use of quantitative capital budgeting appraisal techniques only can lead to the decline of a firm (Hayes & Abernathy, 1980; Hayes & Garvin, 1982). It is now generally accepted that the astute financial manager should consider both quantitative and qualitative factors in the capital budgeting decision (Butler, et al., 1993; Dayananda, et al., 2002; Marino & Matsusaka, 2005; Pohlman, et al., 1988; Van-Cauwenbergh, et al., 1996). According to Butler et al. (1993), qualitative factors can be grouped into three categories: (1) strategic factors; (2) risk factors; and (3) performance factors.

It has been noted that biasing of capital budgeting proposals has its foundations in asymmetric information (Bohlin, 1997). Although long-term contracts can assist in mitigating the information asymmetry problem (Antle & Fellingham, 1990; Haka, 1987; Larker, 1983), it cannot be eradicated, because owners do not have access to the costless private information.
of their manager(s) (Cremer & Khalil, 1992, 1994; Cremer, et al., 1998). To counter this, organisations often craft their own normative rules concerning how capital budgeting ideas are formally generated, analysed and evaluated (Simonson & Staw, 1992). Owners can also become involved in the preparation of capital budgeting proposals in an effort to reduce the amount of asymmetric information (Antle, et al., 1999). Despite the merits of such an approach, owner involvement in the preparation of capital budgeting proposals signifies higher monitoring costs (Harris & Raviv, 1996). The next chapter builds on the current chapter by providing an overview of the capital budgeting literature specific to hotels.
CHAPTER 6
THE HOTEL CAPITAL BUDGETING LITERATURE

6.1 Introduction

The purpose of this chapter is to provide an overview of the hotel capital budgeting literature that is most pertinent to this study. To do this, the remainder of the chapter is organised as follows. The first section provides an overview of hotel capital budgeting. The second section details issues associated with the strategic focus and timing of hotel capital expenditure. The third and fourth sections outline the use of quantitative and qualitative capital budgeting appraisal techniques in hotels. The fifth section describes the literature relating to the biasing of capital budgeting proposals in hotels. The sixth section reviews the use of the Furniture, Fittings, and Equipment (FF&E) reserve in the hotel capital budgeting process. The final section provides a concluding commentary for the chapter.

6.2 Hotel capital budgeting

Hotels are vibrant organisations that are characterised by buildings that are complicated and costly to maintain (Chan, Lee, & Burnett, 2001). The most important budget in a hotel is the capital budget because of its strategic significance (Condon, Blaney, & Harrington, 1996; Lynch, 2002). As soon as a hotel opens its doors, managing capital expenditure will become an integral part of its life if it is to become successful (Paneri & Wolff, 1994). The study of hotel capital budgeting is particularly appealing because it is distinctly different to other business settings due to the dual nature of a hotel involving both property and management and also because hotel groups have a high proportion of capital intensive assets that are long-lived (Collier & Gregory, 1995a).

Guilding (2003, 2006) also highlights that where hotels operate under management contracts, capital budgeting is rendered more complex because the decision must cross an organisational divide in order to satisfy the investment appraisal criteria of both the owner and the operator. Operators are typically responsible for the preparation of the capital budget and the owner usually has to approve it (Rushmore, 2002). The propensity of an owner to approve the capital budget can be expected to vary across management contracts and can be affected by the relative locus of power between the owner and the operator. In some
situations the owner is simply given a copy of the capital budget and then it becomes effective immediately, while in other situations the owner will review the capital budget, make comments and then approve some elements of the capital budget or the entire capital budget at their discretion (Rushmore, 2002). In preparing the capital budget, operators are typically required by the owner to include a detailed listing of all necessary capital expenditures, a concise explanation of why the capital expenditure is necessary and an identification of the aspect of the hotel property that the capital expenditure will improve (Rushmore, 2002). This listing will normally indicate the manner in which the cost will be funded as well as a time frame for its occurrence (Rushmore, 2002).

In addition to the annual capital budget, hotel management are typically responsible for the preparation of a three to five year capital budget plan (Beals & Denton, 2004; Brooke & Denton, 2007; Crandell, 2002; Denton, 1998). The objective of this plan is to enable hotel owners to determine which capital projects are critical to the survival of their hotel (Brooke & Denton, 2007). This longer-ranging capital budget plan is also typically updated on an annual basis (Beals & Denton, 2004; Crandell, 2002). A number of problems typically arise, however, with respect to the development of long ranging capital budget plans. These include: (1) that the plan is typically based on an assessment of ‘how much money there is to spend’ rather than a hotel property’s true capital needs; (2) that the plan usually spans only five years so there is little idea of what capital requirements are necessary in year six and beyond; (3) that there is no incentive for operators to be thorough or to address mechanical items or major repairs that have no impact on the ‘cosmetic’ appeal of the property because to operators, cosmetic appeal is important in increasing their management fee; (4) the development of capital budget plans requires the operator to have great skill in cost estimation, which can often be beyond their skill set; and (5) regardless of how thorough the capital budgeting plan is, unanticipated or unbudgeted capital items tend to occur on a regular basis (e.g. equipment breakdowns) (Beals & Denton, 2004; Crandell, 2002; Denton & Yiankes, 2004).

6.3 Strategic focus and timing of capital spending

The strategic focus and timing of capital expenditure is an important issue to hotel owners in their acceptance of the capital budget plan. If there are unanticipated changes in the hotel market, for example, an economic downturn, then a strategy of high capital spending may not
deliver increased property value or an infusion of revenue as desired (Williams, 1997; Wong & Norman, 1994). In trying to predict these market conditions, where the market for selling hotels is depressed with high volatility, the preferred capital spending strategy will be to wait rather than spend (Chu & Sing, 2007). Adoption of this strategy, however, has to be weighed against the disadvantage that a hotelier might face if their competition can seize the first mover advantage by entering the market earlier (Grenadier, 2002; Wang & Zhou, 2006; Williams, 1993). Where a hotelier feels threatened by this, the result can be irrational overbuilding (Grenadier, 2002). On the other hand, Chu and Sing (2007) found that where the market is stronger, with less volatility, there is a greater incentive for owners to increase capital spending.

Hotel owners with properties approaching twenty-five years old also face unique difficulties in their capital budgeting because in such a situation, the owner usually has to decide whether to sell or redevelop the property so as to overcome both internal and external deterioration of the product (Younes & Kett, 2007). Davis and DeRoos (2004) explain that if the owner does decide to carry out the required capital works at this time, then this decision will typically be taken if they believe that they can carry out the required renovations, repositioning and/or change in use of the property, cheaper than an incoming owner. As a result, the preparation of capital budgets within hotels reaching the age of twenty-five years is of heightened importance due to the need of an existing owner avoiding passing on a potentially ‘good deal’ to a new buyer. Owners with short-term investment holding periods such as five years or less, are typically characterised by a market timing strategy of ‘buy low and sell high’, which may not take into consideration capital spending to the same degree as a longer-term oriented hotel owner (Davis & DeRoos, 2004). For these short-term oriented owners, the capital budgeting decision becomes tactical rather than strategic (Davis & DeRoos, 2004). The choice of when to renovate can frequently be as important as the renovation itself (Sullivan, 1994). Evidence also suggests that hotels with low capital requirements are more attractive to potential buyers (Niehaus, 2008). If a hotel requires some work, buyers may favour this if they are seeking a reasonably priced property to reposition, because they believe that they can spend capital in a way that will enhance value (Niehaus, 2008). These types of buyers, however, will typically “bargain hard because of the risks and temporary loss of income associated with renovation” (Niehaus, 2008, p. 47). The timing of capital expenditures should therefore be carefully investigated by hotel management (West & Hughes, 1991).
6.4 Use of quantitative and sophisticated capital budgeting appraisal techniques in hotels

Guilding and Lamminmaki (2007) reviewed the evolution of hotel capital budgeting appraisal techniques. This review highlighted that in U.S. hotels, during the period 1975 to 1980 payback and return on investment (ROI) were the most popular capital budgeting appraisal techniques adopted (Eyster & Geller, 1981). By the early 1990s, however, Schmidgall and Damitio (1990) found that sophisticated capital budgeting appraisal techniques, such as IRR and NPV were being used to a greater extent. By the mid 1990s, a wide range of applications for different capital budgeting appraisal techniques were reported in U.K. hotels (see e.g. Collier & Gregory, 1995a; Collier & Gregory, 1995b). By the 2000s, Damitio and Schmidgall (2002) reported a study of the use of NPV, IRR, payback and accounting rate of return (ARR) in U.S. hotels over a ten year period from 1990 to 1999. This showed a general reduction in the use of sophisticated capital budgeting appraisal techniques. The results of the study are presented in Table 6.1.

<table>
<thead>
<tr>
<th>TABLE 6.1</th>
<th>Use of quantitative capital budgeting appraisal techniques in U.S. hotels between 1990 and 1999</th>
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<tbody>
<tr>
<td></td>
<td>Level of sophistication</td>
</tr>
<tr>
<td>Internal rate of return (IRR)</td>
<td>High</td>
</tr>
<tr>
<td>Net present value (NPV)</td>
<td>High</td>
</tr>
<tr>
<td>Payback</td>
<td>Low</td>
</tr>
<tr>
<td>Accounting rate of return (ARR)</td>
<td>Low</td>
</tr>
<tr>
<td>Adapted from: Damitio and Schmidgall (2002, p. 39)</td>
<td></td>
</tr>
</tbody>
</table>

More recently, Guilding and Lamminmaki (2007) also found evidence of limited use of sophisticated capital budgeting appraisal techniques with over half of the Australian hotels they surveyed exclusively using the payback method.

Guilding (2003) claims that management contract operated hotels are more likely to have greater formalisation of capital budgeting practices than non-management contract operated hotels. With regard to the meaning of ‘formalisation’, Guilding (2003) explains that the capital budgeting process is formalised where there is high “systematic study of issues” (Langley, 1990, p. 17), as well as importance attached to the use of formal analysis using quantitative capital budgeting appraisal methods such as NPV, IRR, payback and ROI (Van-
Drawing on agency theory, Guilding (2003) outlined an expectation of higher degrees of capital budgeting formalisation in management contract operated hotels because, as Baiman (1990, p. 344) notes:

… one would expect to find a managerial accounting procedure only in contexts in which individuals would benefit from its use – by mitigating motivational problems within firms made up of self-interested individuals.

Guilding’s (2003) expectation of greater formalisation of the capital budgeting process in management contract operated hotels also derives from Brunsson (1989) who noted that the role of formal analysis in capital budgeting is primarily symbolic because rational organisations are an illusion, but displaying an image of using formalised procedures can protect themselves in this light.

Figure 6.1 presents Guilding’s (2003) typology of owner / operator structures, which he used as a basis for predicting hotel capital budgeting formalisation under different types of hotel ownership structure.

<p>| FIGURE 6.1 |</p>
<table>
<thead>
<tr>
<th>Typology of hotel owner/operator structure and implications for capital budgeting formalisation</th>
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<tbody>
<tr>
<td><strong>Large owning company</strong></td>
</tr>
<tr>
<td><strong>Divorced owner/operator structure</strong> (i.e. management contract)</td>
</tr>
<tr>
<td><strong>Unified owner/operator structure</strong> (i.e. owner-operator)</td>
</tr>
</tbody>
</table>

Adapted from Guilding (2003, p. 193)

It was not Guilding’s (2003) intention to capture all permutations of hotel owner / operator structures in Figure 6.1. The ‘divorced owner / operator structure’ can be seen as constituting the management contract hotel ownership structure and, at the other end of the spectrum, the ‘unified owner / operator structure’ can be seen as the owner-operator hotel ownership structure. A further key factor captured by Guilding (2003) was the issue of owner size. Larger owners are expected to use more formalised capital budgeting procedures. Guilding (2003) also noted that there could be an expectation of a positive relationship between the size of a hotel operator and the formalisation of capital budgeting appraisal techniques adopted. Given that hotel operators hold little if any equity stake in the hotels that they...
operate, however, it was expected that the size of the owner would be the more significant determinant of capital budgeting formalisation.

6.5 Use of qualitative capital budgeting appraisal techniques in hotels

Normative comment in the mid to late 1980s suggested that to improve the capital budgeting systems deployed in hotels, a greater emphasis needed to be placed on the use of qualitative capital budgeting appraisal techniques (see Eder & Umbreit, 1987; Schmidgall & Ninemeier, 1987). Despite such recommendations, in the mid 1990s, members of the hotel industry, regardless of their size, continued to place considerable importance on quantitative capital budgeting techniques (DeFranco, 1997). This is because quantitative capital budgeting techniques are viewed as being a powerful tool in the performance appraisal and control process (Brander-Brown, 1995; T. Jones, 1998). Surprisingly, the study of qualitative capital budgeting appraisal techniques has continued to receive little attention from academics researching the hotel setting. An extensive literature search has found only one study that had investigated the issue in any great detail. This was the study carried out by Guilding (2006).

Drawing on interview data collected from hotel general managers and financial controllers, Guilding (2006) sought to rank the importance of four different perspectives associated with capital budgeting appraisal that comprised: (1) financial analysis; (2) strategic analysis; (3) internal political factors; and (4) managerial intuition. Guilding’s justification for inclusion of the four perspectives listed above was as follows:

Due to the large literature concerned with financial appraisal techniques used in investment appraisal, little justification for this study’s inclusion of the first perspective, ‘financial analysis’ is warranted. The second perspective, ‘strategic analysis’, has also been subjected to extensive consideration in the context of investment appraisal (e.g. Carr & Tomkins, 1996; Marsh, et al., 1988; Shank, 1996). The third perspective, ‘internal political factors’, was explored by Butler et al. (1993). Political models of decision making view organizations as a coalescence of potentially competing, self-interested individuals employing guile and strategies, such as coalition building, in the pursuit of their own personal ends (Hickson, et al., 1986; Pfeffer, 1981). The importance of the fourth perspective, ‘managerial intuition’, has been considered in the context of investment appraisal by Butler et al. (1993) and Van Cauwenbergh et al. (1996) (Guilding, 2006, p. 410).

Guilding (2006) found that of the four different perspectives applying to the capital budgeting process, the qualitative perspectives of strategic factors, managerial intuition and internal politics ranked first, third and fourth respectively in terms of importance, relative to financial
(quantitative) factors, which ranked second. These results suggest relatively high use of qualitative capital budgeting appraisal techniques by hotels.

The high importance attached to strategic factors documented by Guilding (2006) receives support from Collier and Gregory (1995a, p. 419) who commented:

In the hotel industry issues such as branding, location and package style (e.g. tour versus business hotel, star ratings, fitness and leisure facilities, etc.) are of fundamental importance. All of our sample companies were well aware of this, and appeared to assign more importance to these strategic areas than to the pure numerical analysis.

In connection with Guilding’s ranking exercise findings, although ‘internal political factors’ ranked of least importance, Guilding (2006, p. 416) argues that:

Political factors appear worthy of further comment due to the extent to which they signify a perspective that is distinct from financial and formalized models of investment decision-making. Further, relative to the single company context of the conventional investment decision, there would appear to be greater scope for politicality in investment decision-making in hotels under a divorced owner / operator structure [i.e. a management contract].

Guilding (2006, p. 416) believes that political factors will be heightened in hotels operating with a management contract because “the capital budgeting process must transcend the boundary between two organizations.” He found support for this expectation, particularly in those hotels where the hotel owner and/or operator are large. In a questionnaire survey conducted by Guilding and Lamminmaki (2007), it is pertinent to note that although their focus was on the use of quantitative capital budgeting appraisal techniques in hotels, seventeen per cent of respondents used no quantitative capital budgeting appraisal method at all. This lends further support to the importance of qualitative factors in hotel capital investment appraisal.

6.6 Biasing of hotel capital budgeting proposals

Guilding and Lamminmaki (2007) observe that a number of academic commentaries have noted the potential for optimistic data biasing in capital budgeting, with a resulting tightening of capital rationing by senior managers (Antle & Eppen, 1985; Hirshleifer, 1993; Holmstrom & Costa, 1986). Some empirical support for this view has been provided by Mukherjee and Hingorani (1999). In capital budgeting it is important for top management to develop a culture that encourages managers to seek, identify and promote a willingness to collect
information that is externally-oriented and often non-financial (Gordon & Pinches, 1984).

Butler et al. (1993, p. 53), for example, comments:

Any manager who has experienced the hurt and frustrations of having an investment proposal dismissed or an accepted proposal fail is likely to develop an in-built resistance to creating further proposals unless the organization culture rewards are conducive to such activity.

Within management contract operated hotels, however, Guilding (2006, p. 413) explains that the issue of a supportive corporate culture is more complicated. He states:

The involvement of two contracting parties raises the spectre of an organizational fracture in the ‘culture setting’ and ‘incentive providing’ senior management roles which are normally conducted within the confines of a single organisation. In the hotel industry, the owning company’s position as the party funding capital expenditure highlights its fundamentally significant role in capital budgeting ‘culture setting’. Incentives for the general manager (whose position can be seen as pivotal to the dissemination of a capital expenditure initiation culture), however, are set by the operating company, as the operating company employs the general manager.

As a result of the unique capital budgeting arrangement that arises from the use of a hotel management contract, Guilding (2003) suggests that where operators wish to establish a long-term relationship with the owner, they will be more likely to engage in an underestimation of cash flows. On the other hand, operators nearing the end of their management contract and with a diminished desire to renew the contract will be more likely to engage in an overestimation of cash inflows. Guilding (2003, p. 194) identifies two factors that give hotel operators an incentive to be relatively “bullish” by inflating projected revenues and deflating projected expenditures when initiating capital budgeting proposals. The first of these reasons is noted by Field (1995) who explains that it is the owner that bears the main burden of a failed capital expenditure project. Secondly, Guilding (2003) comments that the method of remuneration of the operator (i.e. typically a base fee tied to gross revenue and an incentive fee tied to a percentage of gross operating profit) means that operators have an incentive to promote projects that have high total revenue and high total profit, with little regard to the return on those investments. Guilding (2003), however, found only mixed support for his predictions, with some interviewees being supportive of the optimistic biasing effect, whereas other interviewees suggested a negative biasing effect.

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1 A detailed discussion of deficiencies in owner-operator capital expenditure goal congruency in hotel management contracts is presented in Chapter 7.
With regard to the potential for a negative biasing effect, Guilding (2003) explains that this will be heightened any time an owner attaches significant importance to the metering of outputs of an agent rather than monitoring their behaviour (Sharma, 1997). Such a metering approach is usually adopted where a hotel owner monitors an operator’s performance relative to capital budgeting proposal forecasts. The propensity of owners adopting such a metering approach is heightened in hotels operated under a management contract as this metering resembles a type of post-investment audit (Mills & Kennedy, 1993; Neale, 1989).

The incentive for operators in management contract hotels to engage in negative biasing of capital budgeting proposals can also be explained by drawing on the rationale espoused by the budgetary slack literature (see e.g. Dunk, 1993; Lukka, 1988; Waller, 1988). Guilding (2003) explains that where operators have high participation in the preparation and formulation of capital budgeting proposals, this usually gives the operator a high degree of information asymmetry relative to the owner (Baiman & Evans, 1983; Penno, 1984). Where this is the case, if a hotel owner uses budgeted data as a performance measure for the operator, then the operator is likely to have high budgetary slack (Dunk, 1993). Under such conditions, Guilding (2003) found that operators often use flawed logic as part of the justification for capital budgeting projects as it is difficult for an owner to ‘police’ such behaviour. As already noted, however, in many management contract operated hotels owners are increasingly engaging asset managers to act on their behalf to implement this monitoring function (Armitstead, 2004; Swing, 2004). The engagement of an asset manager can facilitate a more productive alignment of interests between the owner and operator (Capital Hotel Management, 2006b; Feldman, 1995; Geller, 2002).

In an attempt to reduce potential biasing of capital budgeting proposals by operators, Guilding (2006) explains that owners can become more involved in their preparation. Greater participation from both principals and agents can reduce the dysfunctional problems of game-playing and feelings of tension and mistrust that can arise in the development of hotel capital budgeting proposals (see Brander-Brown, 1995; Ferguson & Berger, 1986; O'Dea, 1985; Pickup, 1985). Where owners become more involved in the preparation of capital budgeting proposals, the opportunity for operators to bias capital budgeting proposals is reduced. On the

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2 The role of the asset manager in management contract operated hotels is discussed further in Chapter 7.

3 In a study of recently negotiated management contracts in Europe, Bader and Lababedi (2007) noted a general increase in the level of owner involvement in key business decisions.
other hand, low hotel owner involvement in the preparation of capital budgeting proposals sees the operator initiate such proposals, which enhances the opportunity for operator biasing. Guilding (2006, p. 419) concludes that:

… in most hotels operating under a divorced owner / operator structure [i.e. management contract], it is the operator that initiates most investment proposals. This is to be expected as, in most cases (particularly when the owner is based overseas), the operator is better-placed to be aware of those parts of the hotel’s physical infrastructure that are in need of overhaul or replacement.

As the bulk of capital budgeting proposals are initiated by the hotel operator, and because a supportive capital budgeting corporate culture is more complicated in management contract operated hotels, Guilding (2006, p. 420) explains that this set of circumstances results in a paradoxical situation because:

… the key hotel player that oversees investment proposal initiation is the general manager, and the general manager is not an employee of the owning company. So the party to a hotel management contract that stands to gain the most from instilling a culture supporting the formulation of high quality investment proposals has muted influence in affecting the organizational culture of the manager with greatest scope to affect investment proposal initiations.

This section has served to highlight the complexity of the capital budgeting process in hotels governed by a hotel management contract.

6.7 The Furniture, Fittings and Equipment (FF&E) reserve

As already indicated by Guilding (2003, 2006), capital budgeting is made more complex where hotels operate under a management contract. A further contributory factor to this additional complexity stems from the fact that the majority of management contracts require the owner to establish a FF&E reserve (Barge & Jacobs, 2001; Eyster, 1988, 1997b; Haast, et al., 2005; K. Johnson, 1999). According to Bader and Lababedi (2007, p. 176):

Included in this [FF&E reserve] category are all nonreal-estate items that are typically capitalised rather than expensed, which means they are not included in the operating statement, but nevertheless affect an owner’s cash flow. Typically, capital improvements are divided into routine capital improvements (which are funded through the FF&E reserve account), which are required to maintain revenues and profits at their present levels, and discretionary capital improvements (also called ROI...
capital improvements). These latter capital improvements are investments that are undertaken in order to generate more revenue and profits, such as the conversion of offices into meeting rooms. The latter require owner approval and are in addition to the funds expended from the reserve account.

A further definition of what should be paid for from the FF&E reserve is provided by Mellen, Nylen and Pastorino (2000, p. 1):

Comparatively, the “reserve for replacement” [i.e. FF&E reserve] for a hotel asset has been narrowly defined as the funds put aside for the periodic replacement of furniture, fixtures and equipment (FF&E). The reserve was not contemplated to fund the replacement of major building components, such as roofs, elevators, and chillers.

Although Mellen et al. (2000) and Bader and Lababedi’s (2007) explanation of what constitutes a payment from the FF&E reserve is helpful, in practice, the distinction between FF&E reserve costs and capital expenditures that are to be capitalised in addition to those expended from the FF&E reserve is somewhat ambiguous.

Despite some difficulties in interpreting what should be paid for from the FF&E reserve, it is widely-held that FF&E reserves are of crucial importance to the smooth running of a hotel, because the FF&E of a hotel are exposed to heavy use and must be replaced at regular intervals (Bader & Lababedi, 2007). FF&E reserves can therefore help to prevent value erosion of a hotel property through the passage of time (Corgel, 2007b). By establishing the reserve, the operator can maintain the hotel in a condition representative of its star rating and also prevent worn-out facilities adversely affecting the hotel’s image, reputation and profitability (Bader & Lababedi, 2007; Rushmore, 2002).

The hotel operator typically administers the FF&E reserve and deposits may be made either from the cash flow of the hotel or on a notional (non-cash) basis, whereby, the allocation is made as an accounting entry in the books, rather than to an actual cash fund (Eyster, 1997b; Haast, et al., 2005). Operators typically prefer cash reserves, while owners prefer notional reserves (Eyster, 1997b; Haast, et al., 2005). This is because operators want to avoid situations where an owner may not be able to supply sufficient funds toward budgeted FF&E projects, whereas, owners want control of their money and prefer to be able to invest it until such time as it is required for a hotel (Haast, et al., 2005). Under both approaches, release of funds from the FF&E reserve is typically achieved only after owner approval (Aghion, Dewatripont, & Rey, 1994; Eyster, 1997a; H. M. Field, 1995; Guilding, 2003; Horwath &
Horwath, 1988; Rushmore, 2002). Where a hotel owner has more than one hotel operated by
the same operating company, it can also be beneficial to pool resources into one central
FF&E reserve fund so as to diversify risk (Denton, 1998).

Due to the differing motivations of owners and operators, allocations and disbursements to
and from the FF&E reserve can be a major source of friction (Australia New Zealand &
Pacific Hotel Investment Conference, 2006a). The amount allocated to the FF&E reserve is
typically agreed between owner and operator and is set at an amount necessary to replace all
existing FF&E with new FF&E over an assumed useful life (Eyster, 1997a; H. M. Field,
1995; Guilding, 2003; Rushmore, 2001). The general rule is that the FF&E reserve should
have sufficient funds to cover future replacements on an ‘as needed’ basis, while at the same
time, not allow excess funds to accumulate, as this can reduce profit (Rushmore, 2002). The
accumulated dollar amount in the FF&E reserve is usually minimal as the replacement of
FF&E is an ongoing process (Rushmore, 2002). Owners frequently require approval of
competitive bids on all FF&E reserve funded requests from operators as well as cost-benefit
analyses where these expenditures rise above a negotiated amount (Eyster, 1997b). The
significant cost of FF&E is apparent from the fact that, at any time, a hotel’s FF&E can
account for up to twenty-five per cent of the value of a hotel property (Rushmore & Baum,
2001). Table 6.2 highlights the importance of FF&E expenditure costs across different hotel
classes on a per room per annum basis in the United States.

<table>
<thead>
<tr>
<th>Class of hotel</th>
<th>Amount per room per annum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Luxury</td>
<td>US$14,800 to US$32,300</td>
</tr>
<tr>
<td>Standard</td>
<td>US$10,400 to US$18,300</td>
</tr>
<tr>
<td>Economy</td>
<td>US$5,400 to US$9,900</td>
</tr>
</tbody>
</table>

Achieving a more accurate understanding of what constitutes a sufficient allocation to the
FF&E reserve represents one of the biggest challenges facing the hotel industry worldwide.
Mellen et al. (2000, pp. 2-3), for example, outline that:

[The hotel] sector is grappling, to varying degrees, with the concept of how much …
is required to maintain income producing real estate assets in good condition and how
much is the right amount to set aside (as a reserve) … ‘The truth will set us free’
[because] … If the true cost of owning real estate is established, then the yields to be
earned on this most illiquid of investments can be predicted with greater accuracy which, in turn, will theoretically attract more capital to our industry.

Allocations to the FF&E reserve are typically achieved via a predetermined percentage of gross revenue (Rushmore, 2002). This percentage is normally low in the early years of a hotel property’s life and then ‘ramped up’ until around year five to seven where a maximum stabilised percentage is reached (Eyster, 1997b; Rushmore, 2002). The reason for this ‘ramping up’ is that soft-goods are generally replaced every five to seven years, whereas larger items, such as roofs and kitchens, may need replacing every twenty-five to thirty years (Denton, 1998). Since the 1930s, the general rule of thumb has been that annual contributions to the FF&E reserve should be set at roughly three per cent of annual gross revenues after ramping up (Brooke & Denton, 2007; Phillips, 2003; Ransley & Ingram, 2001). Table 6.3 provides an overview of prior empirical research investigating amounts allocated to FF&E reserves.

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5 Two less widely-applied approaches to determining the allocation of funds to the FF&E reserve are to use an annual fixed dollar amount or a negotiated yearly amount (Rushmore, 2002).
<table>
<thead>
<tr>
<th>Author</th>
<th>Geographic region</th>
<th>Contracts analysed</th>
<th>Incidence</th>
<th>Style of allocation</th>
<th>Typical allocation made as a % of annual gross revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eyster (1988)</td>
<td>U.S. (58 contracts) &amp; international (19 contracts)</td>
<td>77</td>
<td>Most common</td>
<td>Ramps up</td>
<td>1 – 2% while ramping up. Once stabilised 3 – 4%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Fixed</td>
<td>3 – 4%</td>
</tr>
<tr>
<td>Eyster (1997b)</td>
<td>U.S.</td>
<td>18</td>
<td>Most common</td>
<td>Ramps up</td>
<td>Up to 3% while ramping up. Once stabilised 3 – 5%.</td>
</tr>
<tr>
<td>Johnson (1999)</td>
<td>U.S.</td>
<td>45</td>
<td>58%</td>
<td>Fixed</td>
<td>4%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>42%</td>
<td>Ramps up</td>
<td>Did not specify a percentage whilst ramping up (up to 10 years). Once stabilised 4%.</td>
</tr>
<tr>
<td>Burge and Jacobs (2001)</td>
<td>Asia-Pacific (Australia included)</td>
<td>50</td>
<td>62%</td>
<td>Ramps up</td>
<td>1 – 5% while ramping up (usually 3 years). Once stabilised, most common allocation 3%, average allocation 3.32%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>22%</td>
<td>Fixed</td>
<td>Most common allocation 3%, average allocation 2.95%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>16%</td>
<td>No FF&amp;E reserve</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>29</td>
<td>55%</td>
<td>Ramps up</td>
<td>0 – 5% while ramping up (usually 5 years). Once stabilised, most common allocation 4% and 5%, average allocation 4.03%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>17%</td>
<td>Fixed</td>
<td>Most common allocation 3% and 5%, average allocation 4%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>28%</td>
<td>No FF&amp;E reserve</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>25</td>
<td>36%</td>
<td>Fixed</td>
<td>Most common allocation 4%, average allocation 4.11%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>28%</td>
<td>Ramps</td>
<td>0 – 5% while ramping up. Once stabilised, most common allocation 5%, average allocation 4.21%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>36%</td>
<td>No FF&amp;E reserve</td>
<td>-</td>
</tr>
<tr>
<td>Haast, Dickson, and Braham (2005)</td>
<td>Asia-Pacific (Australia included)</td>
<td>28</td>
<td>46%</td>
<td>Ramps</td>
<td>0.5 – 5.5% while ramping up. Once stabilised, most common allocation is 3%, average allocation is 3.46%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Fixed</td>
<td>Most common allocation 3%, average allocation 2.96%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Flat fee</td>
<td>Did not specify.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>No FF&amp;E reserve</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>29</td>
<td>52%</td>
<td>Ramps up</td>
<td>1 – 5% while ramping up (typically 3 – 5 years). Once stabilised, most common allocation is 4%, average allocation 4.15%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Fixed</td>
<td>Most common allocation 3%, average allocation 3.5%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>No FF&amp;E reserve</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>25</td>
<td>60%</td>
<td>Fixed</td>
<td>Most common allocation 4% and 5%, average allocation 4.2%.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Ramps up</td>
<td>1 – 6% while ramping up. Once stabilised, most common allocation 4%, average allocation 4.6%.</td>
</tr>
</tbody>
</table>
Table 6.3 highlights that there has been an increasing incidence of FF&E reserve usage. It also shows that in many cases, more than the ‘rule of thumb three per cent of annual gross revenue’ is contributed to the FF&E reserve. As noted above, the two main approaches to determining FF&E reserve contributions are based on ramping up and a fixed amount. Under both approaches, there appears to be considerable variation in the amounts allocated to the FF&E reserve. Much of the reason for this is that today, hotel owners and operators are realising that three per cent is insufficient to cover the true cost of FF&E expenditure, as it ignores plant life cycles, routine maintenance costs, the ageing of a hotel building and does not provide sufficient funding for the replacement of short-lived items (Ferguson & Selling, 1985; Ransley & Ingram, 2001; Reichardt & Lennhoff, 2003). Hotel property ageing appears to be the most pronounced reason for the inadequacy of FF&E reserve funding (Brooke & Denton, 2007; Mellen, et al., 2000).

Aside from the fact that FF&E reserves appear to be grossly underfunded, owners are beginning to recognise that a strategy of spending only three per cent of gross revenue annually on FF&E can work against their hotel’s long-term profitability, value and star-rating (Bader & Lababedi, 2007; Stock, 2004). If funding is insufficient, FF&E projects that need to be completed might have to be deferred or eliminated (Bader & Lababedi, 2007; Beals & Denton, 2004; Crandell, 2002). Bankers and lenders are also beginning to impose covenants on owners that mandate that allocations be made above the three per cent annual amount so as to protect their investment (Crandell, 2002; Denton, 1998; Wilder, 2004). It is thought that after ramping up in the early years of a hotel’s life is complete, to cover the true cost of FF&E expenditure, the required figure is closer to five (see Eyster, 1997b), greater than five (see Haast, et al., 2005), or even six per cent of annual gross revenue (see Australia New Zealand & Pacific Hotel Investment Conference, 2006b). The actual amount allocated to the FF&E reserve, however, differs from hotel to hotel and is contingent upon a number of factors that include: (1) the level of competition the hotel faces in its market; (2) the financial resources of the owner and/or operator; (3) the quality of the construction of the hotel; (4) the age of the property; (5) the location of the hotel; and (6) the philosophy and strategic approach taken by the stakeholders in the asset (Phillips, 2003). Interestingly, these factors have contributed to FF&E reserve allocations being generally lower in the Asia-Pacific region as opposed to in Europe and the United States (Barge & Jacobs, 2001). Public hotel organisations have also been found to spend slightly more on FF&E than private organisations (Brooke & Denton, 2007).
Despite some of the more recently negotiated management contracts featuring a higher allocation, there is still widespread continued use of the three per cent of annual gross revenue allocation to the FF&E reserve. There are several potential reasons for this. One of these is that operators like to see the percentage kept low (with the major burden being borne by capital budgets), because allocations to the FF&E reserve can sometimes have an impact on the incentive management fee paid to operators (Rouse, 2004). It must be noted, however, that by reducing the allocation to the FF&E reserve, more control is handed to the owner regarding the expenditure of capital. An operator could therefore be expected to weigh the costs versus the benefits of a strategy designed to increase contributions to the reserve fund.

A further reason for the continued use of the three per cent allocation to the FF&E reserve is that to use a higher figure might lead to the value of a hotel property falling because buyers might perceive the hotel as being too expensive to operate. In addition, a realistic amount might send a negative signal to potential financing and development companies, as it might cause them to increase their perceived risk of investment (P. Berg & Skinner, 1995). Also, hotel owners are typically opposed to higher allocations to the FF&E reserve because it is challenging to link cause and effect regarding the worthiness of the expenditure (Higley, 2005c; Phillips, 2003). Finally, FF&E expenditure can be affected by economic cycles, so a balance between distributing funds between owners and the FF&E reserve is important, so as to not affect share price (Phillips, 2003). The need for higher FF&E reserve allocations seems to be well illustrated by the increased willingness of hotel operators to contribute equity in order to purchase some or all of a hotel’s FF&E (Goddard & Standish-Wilkinson, 2002). The insufficiency of funding in the FF&E reserve has also lead to operators seeking to negotiate additional reserves of the order of one to two per cent of gross revenue to fund other capital expenditure type replacements (Eyster, 1997b).

An interesting development in some of the more recently negotiated hotel management contracts is that they now specify that owners are to provide sufficient FF&E funding to maintain the hotel at a ‘brand standard’, which often means that greater than three per cent be allocated to the FF&E reserve (Haast, et al., 2005). With regard to brand standards, it is increasingly becoming the case that if owners do not meet the operator’s brand standard, they face the unpleasant alternative of having their affiliation with the brand discontinued through

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6 Operator management fees are discussed in greater detail in Chapter 7.
termination of the management contract (Dickson, 2007). Brand standards can allow the operator to terminate an owner’s brand affiliation, and therefore the management contract, based on vaguely worded actions (or inactions) of the owner (Beals & Denton, 2005). There are large variations in the appearance and consistency of hotel chains due to reasons such as local planning constraints and the design specification of FF&E, which can affect brand standards and the amount expended on FF&E (Dickson, et al., 2008; Sheehan, 2005; Slattery, 1991). The imprecise nature of brand standards (see e.g. Crandell, et al., 2004) therefore leads to difficulty in their practical implementation (Dickson, et al., 2008). There is also an ongoing problem with respect to how to adequately and effectively deal with issues and disputes that arise between owners and operators regarding whether brand standards have been complied with (Dickson, 2007). Dickson (2008, p. 12), comments:

For a significant number of brands the relevant brand standards are imprecise. In a number of instances, there is no ready book or brochure which sets out the brand standards in enough detail to support the contractual obligations that a number of management agreements impose or allow an owner to understand what impact the brand standard benchmark will have for them. In particular, it is generally stated that the owner will comply with the brand standards at all times and, in some instances, there is a specific termination provision available to the operator if the brand standards are not complied with. Provisions of this nature are unduly draconian and if strictly enforced would impose harsh consequences on owners.

As further explained by Dickson (2008), a major challenge facing the industry is to find a balance between the operator’s desire for a uniform brand standard, while at the same time allowing prudent management of FF&E reserves and other capital expenditures. Brand standards are often perceived by owners to be depriving them of their rights to question or approve the actions of the operator, effectively forcing them to relinquish control over their properties (Beals & Denton, 2005). If an owner deems a certain capital expenditure as inappropriate on the grounds of a lack of cost effectiveness, for example, operators can often terminate the contract (Beals & Denton, 2005). This issue is of heightened concern due to the fact that brands inevitably seek growth (McCarthy & Raleigh, 2004). Beals (2004, p. 10) explains that compliance with brand standards by owners often creates incentives for operators:

… to overspend, to create even more lavish hotels offering more services and amenities, thus ensuring the brand’s continuing acceptance in the consumer marketplace.

Brand standard clauses therefore can leave owners in a situation where they must finance the enhancement of their operator’s brand while at the same time suffer from a decline in the
value of their property due to their money being spent in ways that do not translate into a higher performance achieved by the property (Beals & Denton, 2005). “Effectively, the owner is subsidising the brand’s stock price” (Beals & Denton, 2005, p. 134). As further highlighted by Crandell, Dickinson, and Kanter (2004, p. 99):

… an inherent conflict exists between building brand equity and owner’s equity. Oftentimes the operator’s decisions benefit the brand but do not necessarily add asset value – and, in some instances, may detract from the value of the hotel asset.

As a result, compliance with brand standards might require certain capital expenditures that the owner would otherwise not consider productive investments (Crandell, et al., 2004). This means that until there is a wholesale reconsideration of the brand standard test, and a more sophisticated benchmark developed that makes contractual obligations more realistic, there will be cases where owners are forced to engage in capital spending that is not in their interests (Dickson, et al., 2008). Two examples are provided by Dickson et al. (2008, p. 12):

[1] … situations where the hotel has only just installed new TVs in each room, only for the operator to inform the owner that the Brand Standards now requires each room to have “x” plasma screen TVs. The management contract should provide that the timing for replacement should take into account the remaining depreciable life of the TVs. [2] If the Brand Standards requires WiFi systems to be installed in all public areas in the hotel, but evidence shows that would not make a positive impact on the profitability of the hotel, the owner should be entitled to defer this obligation until such time as the operator is able to show that compliance with this Brand Standard will in fact positively impact on the profitability of the hotel.

6.8 The hotel repairs and maintenance budget

Closely related to the hotel capital budget is the repairs and maintenance budget (Brooke & Denton, 2007). Ensuring that buildings and service systems are properly maintained, for example, forms an integral part of a hotel’s ability to generate revenue (Chan, et al., 2001). Indeed, as more institutional and commercial real estate investors become hotel owners, the importance of maintaining a hotel’s physical structure has escalated (Stemerman, Epps, Fraioli, Lee, & Leblebici, 2008). Much of the reason for this may be that time has shown that if a hotel asset is well maintained, the asset will have a longer life (Brooke & Denton, 2007). Increases in repairs and maintenance expenditure can therefore decrease capital spending. On the other hand, excessively high repair and maintenance expenditure can signal that capital spending is being deferred or that the hotel building and its systems are obsolete. Hotel owners may also prefer to flexibly expense or capitalise these costs to meet personal goals (Brooke & Denton, 2007).
Despite the close relation between the capital budget and the repair and maintenance budget, the repair and maintenance budget is usually prepared as a distinct budgetary process in a hotel (Kotas & Conlan, 1997). The repairs and maintenance budget contains similar information to the capital budget except that the items listed relate to expenses contained in the repair and maintenance category of the profit and loss statement (Rushmore, 2002). In this way, the repairs and maintenance budget serves to predetermine these costs and highlight the sequence of work that needs to be undertaken in the forthcoming budgetary period (Kotas & Conlan, 1997).

Budgeted repair and maintenance costs are typically arrived at by investigating: (1) the state of the premises, kitchen, plant, furniture and other equipment; (2) the standard of comfort required by the type of customer catered for; and (3) the current availability of funds (Kotas & Conlan, 1997). The average amount budgeted for repairs and maintenance differs from property to property but is typically in the range of three to four and a half per cent of annual gross revenue (Brooke & Denton, 2007). Differences in the amount allocated generally depend on the age of a property and whether it has been recently renovated and/or repositioned (Brooke & Denton, 2007). It is also said that the total of repair and maintenance expenses along with the total cost of all capital expenditure reflects “the true cost of keeping a hotel competitive over its life cycle” (Mellen, et al., 2000, p. 8).

Agency issues also manifest themselves in the preparation of the repairs and maintenance budget. As outlined by Blazenko and Pavlov (2004), if a manager imposes a more demanding profit standard for repairs and maintenance than on the initial investment, this will add value to the hotel property, which would typically benefit the owner. This situation often means that managers prefer new investments rather than the repair and maintenance of existing investments (Blazenko & Pavlov, 2004). The result is that managers become inclined to leave current investments un-maintained by imposing demanding standards on repair and maintenance expenditure (Blazenko & Pavlov, 2004). Inadequate maintenance, however, can lead to an excessive amount of equipment failure (Chan, et al., 2001). Such a strategy, however, appears to be prevalent with over fifty percent of hotel maintenance expenditure typically being devoted to corrective rather than preventative maintenance works (Chan, et al., 2001). This situation is heightened where a manager’s remuneration is linked to some form of profitability because excessive repair and maintenance expenditure will reduce profit.
Without adequate repairs and maintenance, however, hotels are likely to suffer from reduced profitability as a result of a drop in revenues associated with a loss in customer satisfaction (Chan, et al., 2001; Vorst, 1986). This is because customer satisfaction is strongly linked to financial performance (Fornell, Mithas, Morgenson, & Krishnan, 2006; O'Neill & Mattila, 2006). The customer, for example, is seen as being of unrelenting importance and the driving force behind all revenue management efforts (Milla & Shoemaker, 2008). As a result, customers often play an active role in initiating repairs and maintenance through customer complaints (Kirwin, 1992). Managers, however, out of self-interest, often fail to act upon such complaints and instead direct first priority toward the replacement of equipment or improvements in other items that do not directly affect guest satisfaction (Kirwin, 1992).

6.9 The effect of ego on the hotel capital budgeting process

Hotel owners can be oriented by ego (Antel, 2006; Horwath & Horwath, 1988). In a capital budgeting context this is important because the ‘emotive’ element can override the financial decision (Horwath & Horwath, 1988). As Antle (2006, p. 213) explains:

… owning hotels is often an ‘ego business’ (perhaps akin to owning a football club?), where an owner who has successfully developed a business empire in another sphere, through hard work and sound business judgement, suddenly chucks commercial reason out the window on the hotel project.

Guilding (2006, p. 415) notes that “ego-trip oriented ownership appears to be closely related to an ostentatious desire to own a lavish hotel decorated with expensive furniture and fittings”. Where ego-trip ownership is present, it is likely to be easier for the operator to secure owner support for proposed capital expenditure (Guilding, 2006).

A good example of the way in which an ego-trip oriented hotel owner goes about the important decision of capital spending is provided by Baltin and Cole (1995, p. 36) as follows:8

The market-product-location balance [which are considered rational considerations in the decision to spend capital] is too often overlooked by owners … who become entranced with style details. In these cases, focus on the target market is replaced by deliberations over changing from a Spanish colonial to a French chateau style or

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7 A similar terminology for ‘ego-trip’ oriented hotel owners is “trophy buyers” (see Allison, 2004, p. 56).
8 It is pertinent to note that sometimes this scenario can work in reverse, where “owners are asked to fund improvements for the benefit of the operator’s ego” (Pinkowski, 1995, p. 23).
going for an upscale contemporary feel to complement a piece of sculpture someone thinks will absolutely “make” the lobby, all the while overlooking the market the property should be shooting for.9

6.10 Conclusion

This chapter has reviewed the literature concerned with the hotel capital budgeting literature. The first section suggested that the most important budget in a hotel is the capital budget because of the strategic significance of capital expenditure (Condon, et al., 1996; Lynch, 2002). The context of capital budgeting appears to be more complex in the presence of a hotel management contract (Rushmore, 2002).

Prior research into the use of sophisticated vs. simple and quantitative vs. qualitative capital budgeting appraisal techniques in hotels was also described. Since the 1990s, the use of sophisticated capital budgeting appraisal techniques appears to have been on the decline in hotels. Associated with this, there appears to be increased importance placed on the use of qualitative capital budgeting appraisal techniques. A difficulty with this, however, is that it has only been in recent times that qualitative research (see e.g. Guilding, 2006) has identified perspectives associated with such an approach. It would seem appropriate for future research to be directed towards the development of further insight to the use of qualitative capital budgeting appraisal techniques in hotels.

The chapter then moved to a discussion of biasing of capital budgeting proposals in hotels. It was shown that as a result of the unique capital budgeting arrangement that arises in the context of a hotel management contract, hotel operators face numerous motives to either positively or negatively bias capital budgeting proposals (Guilding, 2003). This tendency can be countered by owners becoming more involved in capital budget preparation.

The nature of FF&E reserve accounting was also extensively explored. FF&E reserves are of crucial importance to preventing value erosion of a hotel property through the passage of time (Corgel, 2007b). Due to the differing motivations of owners and operators, however, allocations and disbursements to and from the FF&E reserve can be a major source of friction (Australia New Zealand & Pacific Hotel Investment Conference, 2006a). Such friction

9 Similar comments are also made by Daneshkhu (1998) and Wagner (1998).
appears to be eased somewhat where owners are ego oriented (see Guilding, 2006). Allocations to the FF&E reserve are typically achieved via a predetermined percentage of gross revenue (Rushmore, 2002), which is typically set at three per cent of annual gross revenue (Brooke & Denton, 2007; Phillips, 2003; Ransley & Ingram, 2001). Today, however, there is growing awareness that three per cent is insufficient to cover the true cost of FF&E expenditure (Ferguson & Selling, 1985; Ransley & Ingram, 2001; Reichardt & Lennhoff, 2003). As a result, some of the more recently negotiated management contracts now specify that owners are to provide a greater allocation in order to maintain the hotel at a ‘brand standard’ (Haast, et al., 2005). Despite this, there is still widespread continued use of the three per cent of annual gross revenue allocation to the FF&E reserve. The next chapter advances a novel consideration of hotel owner-operator capital expenditure goal congruency in hotels operated via management contracts.
CHAPTER 7
HOTEL MANAGEMENT CONTRACTS AND DEFICIENCIES IN OWNER-OPERATOR CAPITAL EXPENDITURE GOAL CONGRUENCY

7.1 Introduction

Beals and Denton (2005, p. 144) contend that expectations concerning operators’ expenditure of owners’ money in the most appropriate manner have been severely undermined by observations in the field as well as law court judgements. This suggestion of sub-optimal expenditure of owners’ capital beckons a fundamental examination of this critical aspect of the owner-operator relationship. Dickson, Williams, and Lee (2008) feel that in order to improve goal alignment between owner and operator, the hotel industry needs to develop an operator incentive mechanism that embraces operating performance throughout the course of the management contract and also recognises hotel resale value.

The purpose of this chapter is twofold. Firstly, it seeks to provide an examination of management contract provisions pertaining to hotel operator remuneration and also metrics used in performance assessment and to explicate shortcomings of these provisions in promoting owner-operator capital expenditure goal congruency. Secondly, it examines the relative merits of alternative bases for determining a hotel operator’s fee level. The importance of remunerating a hotel operator in a manner that will promote owner-operator capital expenditure goal congruence becomes particularly evident when we recognise that it is generally the hotel operator that initiates capital expenditure proposals (Guilding, 2006). Should a lack of capital expenditure goal congruence exist between hotel owner and operator, situations are likely to arise where the operator fails to share with the owner a capital expenditure idea that serves the interest of the owner to a significant extent, but only serves the operator’s interest to a negligible degree.

By exploring hotel owner-operator contractual relations, this chapter can be seen to be contributing to agency theory. The remainder of the chapter is structured as follows. The next section provides an examination of the widespread use of operator fee determinants and also termination clause performance measures that undermine owner-operator capital expenditure goal congruency. A consideration of the relative merits of return on investment and residual income as alternative operator fee incentive bases is then provided. The final
section provides a concluding discussion and some suggestions for further research designed to extend insights concerning the dynamics of hotel capital expenditure provided herein.

7.2 Hotel management contracts and owner-operator capital expenditure goal congruency

Due to the considerable agency issues arising in the hotel management contract context, an owner’s choice of operating company and the exact terms of a contract are among the most critical factors determining a hotel’s long-term success (Horwath, 2006). Armitstead and Marusic (2006) note the imperative of designing management contracts that engender goal congruence and the need for hotel owners and operators to consider a wide variety of issues when negotiating a management contract in order to create a ‘win-win’ situation. Berger (1997) comments on the particular importance of the operator’s basis of remuneration, which can be a source of significant tension between the contracting parties.

An operator’s remuneration is widely referred to as a ‘management fee’ (Rushmore, 2002). Three basic management fee structures are found in practice: (1) a base fee only; (2) an incentive fee only; or (3) a base fee combined with an incentive fee (Goddard & Standish-Wilkinson, 2002). The combination of a base and incentive fee is the most common.

With respect to the combined base and incentive fee structure, it has been conventional to view the base element as covering the management company’s operating expenses while the incentive fee contributes to the management company’s profit (Rushmore, 2002). Increasingly, however, greater weight is being attached to the use of higher incentive fees relative to the base fee (Armitstead & Marusic, 2006; Barge & Jacobs, 2001). This development presents operators with greater risk together with the corollary of an increased earnings potential (Goddard & Standish-Wilkinson, 2002; Schlup, 2004). It can also lay the basis for stronger owner-operator goal alignment (Goddard & Standish-Wilkinson, 2002).

While the base fee can be a fixed amount, it is most usually determined as a percentage of gross revenue. This signifies that the term ‘base fee’ is something of a misnomer as it is a variable amount that might be better viewed as an ‘incentive fee’, as it provides operators with an incentive to increase hotel revenue. It is notable that in other contexts, such as the management of investment funds (see e.g. Davanzo & Nesbitt, 1987; Grinold & Rudd, 1987;
Maxam, Nikbakht, Petrova, & Spieler, 2006; Record & Tynan, 1987), franchising (see e.g. Baucus & Baucus, 1997; Baucus, Baucus, & Human, 1993), auditing (see e.g. Giroux & Jones, 2007), and the organisation-supplier relationship (see e.g. Rogers, 2005), a base fee is taken to mean a fixed-dollar amount. Table 7.1 summarises the findings of prior studies concerned with ascertaining how base fees are determined in hotel management contracts. It is evident from this table that internationally, the majority of management contract base fees are determined by gross revenue.
TABLE 7.1
Prior research into the calculation of hotel operator base management fees

<table>
<thead>
<tr>
<th>Author</th>
<th>Geographic focus</th>
<th>Contracts analysed</th>
<th>% incidence</th>
<th>Determinant of base fee and typical amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eyster (1988)</td>
<td>U.S. (58 contracts) &amp; international (19 contracts)</td>
<td>77</td>
<td>55.8</td>
<td>Gross revenue (2 – 7%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10.4</td>
<td>Fixed amount (US$800,000 - $1,400,000 per year)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6.5</td>
<td>Percentage of room revenues (3 – 5%) and of food and beverage revenues (3 – 5%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3.9</td>
<td>Gross revenue (4 – 6%), with portion of fee subordinated to cash flow after debt service (1 – 2%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>13.0</td>
<td>No base fee</td>
</tr>
<tr>
<td>Eyster (1993)</td>
<td>U.S.</td>
<td>17</td>
<td>58.8</td>
<td>Gross revenue (1.5 – 4%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>23.5</td>
<td>Fixed amount (US$36,000 – $180,000/year)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11.8</td>
<td>No base fee</td>
</tr>
<tr>
<td>Sangree and Hathaway (1996)</td>
<td>U.S.</td>
<td>32</td>
<td>-</td>
<td>Gross revenue (2.9% mean)</td>
</tr>
<tr>
<td>Eyster (1997b)</td>
<td>U.S.</td>
<td>18</td>
<td>94.4</td>
<td>Gross revenue (1 – 6%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5.6</td>
<td>Fixed amount (unspecified) + gross revenue (1.5 – 3%)</td>
</tr>
<tr>
<td>Johnson (1999)</td>
<td>U.S.</td>
<td>50</td>
<td>96.0</td>
<td>Gross revenue (2.7% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2.0</td>
<td>Fixed amount (did not specify)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2.0</td>
<td>No base fee</td>
</tr>
<tr>
<td>Barge and Jacobs (2001)</td>
<td>Asia-Pacific (Australia included)</td>
<td>50</td>
<td>66.0</td>
<td>Gross revenue (1.5% mean)</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>24</td>
<td>26.0</td>
<td>Sliding scale (% of gross revenue) / Mixed (% of gross revenue &amp; divisional revenue) / Fixed</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>8.0</td>
<td>No base fee</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>28</td>
<td>66.7</td>
<td>Gross revenue (1.8% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>25.0</td>
<td>Sliding scale (% of gross revenue) / Mixed (did not specify basis) / Fixed</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>8.3</td>
<td>No base fee</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>78.6</td>
<td>Gross revenue (2.7% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>14.3</td>
<td>Gross revenue sliding scale (2.7% mean, after stabilisation)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3.6</td>
<td>Fixed fee (did not specify)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3.6</td>
<td>No base fee</td>
</tr>
<tr>
<td>Goddard and Standish-Wilkinson (2002)</td>
<td>Middle-East</td>
<td>9</td>
<td>44.4</td>
<td>Total revenue (1 – 3%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>33.3</td>
<td>Gross revenue (1.5 – 2.0%)</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>22.2</td>
<td>No base fee</td>
</tr>
<tr>
<td>Haast, Dickson, and Braham (2005)</td>
<td>Asia-Pacific (Australia included)</td>
<td>28</td>
<td>64.3</td>
<td>Gross revenue (1.4% mean)</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>29</td>
<td>17.9</td>
<td>Gross revenue sliding scale (1.4% mean, after stabilisation)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>17.9</td>
<td>No base fee</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>28</td>
<td>62.1</td>
<td>Gross revenue (2.2% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>34.5</td>
<td>Sliding scale (% of gross revenue) / Mixed (did not specify basis) / Fixed</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3.4</td>
<td>No base fee</td>
</tr>
<tr>
<td>Panvisavas and Taylor (2006)</td>
<td>Thailand</td>
<td>8</td>
<td>-</td>
<td>Gross revenue (1 – 6%)</td>
</tr>
</tbody>
</table>
The widespread popularity of revenue determined operator base fees appears somewhat surprising given Feldman’s (1995, p. 43) comment that they provide an incentive for operators to “blithely recommend expenditures that increase top-line revenues that never drop to the bottom line.” With respect to capital expenditure decision making, two implications arise from remunerating operators based on hotel revenue:

1. In line with the issue noted by Feldman, operator remuneration based on revenue provides the operator with an incentive to promote capital expenditure proposals that maximise revenue, without necessarily positively impacting on profit. It signifies that an operator with a base fee incentive of maximising revenue might attempt to promote a capital expenditure proposal that will increase revenues by 20% and carry a negligible (or even negative) impact on profit at the expense of an alternative proposal that will increase revenue by 5% and profit by 10%.

2. An operator with a remuneration based on revenue would have no incentive to initiate cost saving hotel capital expenditure proposals. An example of a cost saving capital expenditure that carries no implication for revenue would be the option of upgrading a washing machine to a sophisticated washer that will result in less laundry labour hours worked, reduced maintenance costs, reduced laundry detergent costs, reduced water consumption and reduced wear and tear to laundered items. Although this type of proposal may have the potential to carry a major positive impact on profit, the absence of any direct effect on revenue may result in operators with a revenue maximising inducement excluding it from any listing of recommended capital expenditure projects tendered to a hotel owner.¹

Table 7.2 summarises prior research findings concerned with the determination of operator incentive fees. From this table it is apparent that most incentive fees are based on either a percentage of gross operating profit (GOP), GOP minus specific charges, cash flow or cash flow minus specific charges. There is a small incidence of incentive fees based on GOP relative to gross revenue, appreciated value of property, percentage above an owner’s priority

¹ These two implications (i.e., promoting revenue maximising projects with no regard given to profit impact, and no incentive to pursue cost cutting projects) will be mitigated where a hotel management contract also provides a separate profit based incentive. Nevertheless, even the presence of a small proportion of an operator’s fee being based exclusively on revenue will introduce a bias causing the operator to weight the importance of revenue maximisation more heavily than cost minimisation or profit maximisation. As the proportion of an operator’s total remuneration that is revenue based is increased, so too will the extent of this bias. Once the proportion reaches 100%, the incentive to minimise costs and maximise profits is nil.
return, a percentage of GOP that exceeds a base fee amount, a percentage of net operating profit (NOP) over a fixed amount or a percentage of the amount by which cumulative cash flow exceeds a cumulative set aside amount.
<table>
<thead>
<tr>
<th>Author</th>
<th>Geographic focus</th>
<th>Contracts analysed</th>
<th>% incidence</th>
<th>Determinant of incentive fee and typical amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eyster (1988)</td>
<td>U.S. (58 contracts) &amp; international (19 contracts)</td>
<td>77</td>
<td>24.7</td>
<td>GOP (3 – 30%).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10.4</td>
<td>GOP less property taxes, insurance, and FF&amp;E reserve allocation (8 – 20%) subordinated (or portion) to debt service (10%).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6.5</td>
<td>Cash flow after property taxes, insurance, FF&amp;E reserve allocation, and debt service (10 – 25%).</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>6.5</td>
<td>GOP after property taxes, insurance, FF&amp;E reserve allocation, and debt service (6 – 16%; or 5% GOP before deductions + 5% GOP after deductions).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>6.5</td>
<td>GOP after property taxes, insurance, FF&amp;E reserve allocation, debt service, and return on equity charge ((10 – 15%; or 5% GOP after debt service + 5 to 10% GOP after required return on equity charge (typically 8 to 10%))).</td>
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<tr>
<td></td>
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<td></td>
<td>5.2</td>
<td>Cash flow after property taxes, insurance, FF&amp;E reserve allocation, debt service, and required return on equity charge ((10 – 30%) (8 – 12% required ROE charge)).</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>3.9</td>
<td>GOP (6 – 12%) + percentage of cash flow after property taxes, insurance, FF&amp;E reserve allocation, and debt service (10 – 25%).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2.6</td>
<td>Dollar amount by which GOP before fixed charges percentage amount percentage amount exceeds gross revenues.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2.6</td>
<td>GOP (8 – 15%) + percentage of cash flow after property taxes, insurance, FF&amp;E reserve, debt service, and return on equity charge ((20 – 40% (7 – 10% ROE charge)).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>19.5</td>
<td>No incentive fee</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>29.4</td>
<td>GOP (5 – 15%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>17.6</td>
<td>Cash flow after debt service (10 – 28%)</td>
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<td></td>
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<td></td>
<td>11.8</td>
<td>Improvement in GOP (10 – 30%)</td>
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<td></td>
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<td></td>
<td>5.9</td>
<td>Adjusted GOP (8 – 20%, adjustment not specified)</td>
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<td></td>
<td></td>
<td>5.9</td>
<td>Cash flow after debt service and return on equity charge (18 – 30%)</td>
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<td></td>
<td></td>
<td></td>
<td>5.9</td>
<td>Appreciated value of property (10%)</td>
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<td></td>
<td></td>
<td>23.5</td>
<td>No incentive fee</td>
</tr>
<tr>
<td>Eyster (1993)</td>
<td>U.S.</td>
<td>17</td>
<td>27.8</td>
<td>Cash flow after debt service (0 – 32%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>22.2</td>
<td>Cash flow after debt service and return on equity (0 – 40%)</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>22.2</td>
<td>Improvement in GOP (8 – 25%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>22.2</td>
<td>GOP subordinated to a negotiated cash flow amount (5 – 10%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>5.6</td>
<td>Improved property value (10 – 25%)</td>
</tr>
<tr>
<td>Sangree and Hathaway (1996)</td>
<td>U.S.</td>
<td>32</td>
<td>Most common</td>
<td>Percentage increase in GOP compared to a predetermined figure (14.0% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Common</td>
<td>GOP (7.9% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Common</td>
<td>Percentage beyond an owner’s priority return (17.1% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Less common</td>
<td>Percentage of GOP that exceeds a base-fee amount (did not specify)</td>
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<td></td>
<td></td>
<td></td>
<td>Less common</td>
<td>Percentage of NOP over a fixed amount (did not specify)</td>
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<td></td>
<td></td>
<td></td>
<td>Less common</td>
<td>Percentage of the amount by which cumulative cash flow exceeds cumulative set-aside amount (did not specify)</td>
</tr>
<tr>
<td>Eyster (1997b)</td>
<td>U.S.</td>
<td>18</td>
<td>27.8</td>
<td>Cash flow after debt service (0 – 32%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>22.2</td>
<td>Cash flow after debt service and return on equity (0 – 40%)</td>
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<td></td>
<td></td>
<td></td>
<td>22.2</td>
<td>Improvement in GOP (8 – 25%)</td>
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<td>22.2</td>
<td>GOP subordinated to a negotiated cash flow amount (5 – 10%)</td>
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<td></td>
<td></td>
<td></td>
<td>5.6</td>
<td>Improved property value (10 – 25%)</td>
</tr>
<tr>
<td></td>
<td>Region</td>
<td>Sample Size</td>
<td>GOP Mean</td>
<td>Incentive Fee Details</td>
</tr>
<tr>
<td>-------------------------</td>
<td>---------------------------------</td>
<td>-------------</td>
<td>----------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Johnson (1999)</td>
<td>U.S.</td>
<td>50</td>
<td>76.0</td>
<td>GOP less property taxes, FF&amp;E reserve allocation, debt service, and owner’s priority return (21% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>12.0</td>
<td>GOP less property taxes and FF&amp;E reserve allocation (did not specify)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>8.0</td>
<td>GOP less property taxes, FF&amp;E reserve allocation, and debt service (did not specify)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>4.0</td>
<td>GOP less property taxes (did not specify)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>4.0</td>
<td>No incentive fee</td>
</tr>
<tr>
<td>Barge and Jacobs (2001)</td>
<td>Asia-Pacific (Australia included)</td>
<td>50</td>
<td>42.0</td>
<td>GOP (8% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>40.0</td>
<td>GOP sliding scale (5 – 10%, most popular range)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10.0</td>
<td>Unspecified</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>24</td>
<td>54.2</td>
<td>GOP (6.9% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>41.7</td>
<td>GOP sliding scale (5 – 15% most popular range)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>4.2</td>
<td>No incentive fee</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>28</td>
<td>21.4</td>
<td>Percentage of the difference between an adjusted GOP (by deducting the base management fee) and a specified percentage of the purchase price of the hotel (25 – 80% of the difference)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>21.4</td>
<td>Percentage of NOP over a certain threshold (unspecified)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>39.3</td>
<td>No incentive fee</td>
</tr>
<tr>
<td>Goddard and Standish-Wilkinson (2002)</td>
<td>Middle-East</td>
<td>9</td>
<td>77.8</td>
<td>GOP (8 – 10%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11.1</td>
<td>Adjusted GOP (14%, adjustment not specified)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>11.1</td>
<td>NOP (17.5%) but operator to receive a minimum of US$180,000 per annum</td>
</tr>
<tr>
<td>Haast, Dickson, and Braham (2005)</td>
<td>Asia-Pacific (Australia included)</td>
<td>28</td>
<td>39.3</td>
<td>GOP (11.2% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>35.7</td>
<td>GOP sliding scale (5 – 10%, most popular range)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>10.7</td>
<td>Other (not specified)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>14.3</td>
<td>No incentive fee</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>29</td>
<td>31.0</td>
<td>Adjusted GOP by deducting the base management fee (9.2% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>27.6</td>
<td>Profit share, which can include:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>● NOP thresholds;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>● Owner’s priority return deducted from GOP; or</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>● GOP targets</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>20.7</td>
<td>GOP sliding scale (5 – 10%, most popular range)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>17.2</td>
<td>Other sliding scales (unspecified)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3.4</td>
<td>No incentive fee</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>28</td>
<td>21.4</td>
<td>NOP after payout of owner’s priority return (20%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>17.9</td>
<td>GOP (7.6% mean)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>21.4</td>
<td>Other (not specified)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>39.3</td>
<td>No incentive fee</td>
</tr>
<tr>
<td>Panvisavas and Taylor (2006)</td>
<td>Thailand</td>
<td>8</td>
<td>Most common</td>
<td>GOP (0 – 10%)</td>
</tr>
</tbody>
</table>
The emphasis attached to profit when determining an operator’s incentive fee would appear to have considerable potential to promote capital expenditure dysfunctionalism. Consider the case of two mutually exclusive projects, where project A requires an initial investment of $1,000,000 and is projected to return $50,000 per annum and project B which requires an initial investment of $500,000 and is projected to return $45,000 per annum. If an operator is remunerated according to an incentive fee that is based on profit, it will prefer project A as it generates the highest profit. However, project B provides a superior return on investment of 9% ($45,000 ÷ $500,000 X 100) compared to project A’s 5% ($50,000 ÷ $1,000,000 X 100) projected return on investment. Prior to taking this investment appraisal methodological analysis further, this simple analysis provides a clear indication that a hotel owner is likely to prefer project B, while an operator remunerated on a basis linked to profit can be expected to prefer project A. At the root of the problem is the reward given to the operator for increasing absolute profit without any need to limit the investment involved. This shortcoming is also present if cash flow is substituted for profit in the scenario outlined.

As already noted, Table 7.2 highlights that some hotel operators’ remuneration is based on GOP or cash flow minus one or more charges relating to asset investment. Remuneration bases that involve these types of deduction would appear to provide a better basis for promoting owner-operator capital expenditure goal alignment. This is because they are algorithms that incorporate a recognition given to asset involvement in generating profit. Charges against profit or cash flow noted in Table 7.2 that give recognition to the involvement of assets in generating profit include: property taxes, insurance, FF&E (furniture, fittings and equipment) reserve allocation, and debt service.

With respect to making a charge for the FF&E reserve allocation, it is noted by Schlup (2004) that because the adequate maintenance of a hotel is also in the best interest of the operator, it appears fair that contributions to the FF&E reserve be treated as operating expenses, signifying a reduced fee paid to operators remunerated on a profit basis. Understanding the implication for an operator when FF&E reserve allocations are deducted from the profit figure used as the basis for making incentive fee payments is complicated, however. To appreciate this we need to recognise that the FF&E reserve allocation is generally set at around 3% of gross revenue (Brooke & Denton, 2007; Phillips, 2003; Ransley & Ingram, 2001). Consider the case of a hotel operator evaluating a capital expenditure opportunity that will provide a $1,000 increase in revenue. If the operator is paid a 3% of gross revenue base
fee, they stand to benefit by $30 (3% of the $1,000 increase in revenue). With respect to the operator’s incentive fee, if the fee is based on profit minus a charge for FF&E reserve allocation and if the allocation is set at 3% of gross revenue, then an additional $30 (3% of $1,000) will be allocated to the FF&E reserve and deducted from the profit basis used for determining the incentive payment. Say that 10% of the adjusted profit is being provided to the operator as their incentive fee, the result of the $1,000 increased revenue on the incentive fee paid is a reduction of only $3 ($1,000 X 3% X 10%).

This worked example highlights the extent to which deducting FF&E reserve allocations from GOP used as the basis for providing incentive fee payments to operators actually contributes minimally to greater owner-operator capital expenditure goal congruency. Further, it is notable that the amount allocated to FF&E reserve does not represent a good proxy for FF&E capital expenditure, as it is widely noted that FF&E reserve contributions fall some way short of the average annual capital expenditure required to maintain FF&E (Barge & Jacobs, 2001; Brooke & Denton, 2007; Eyster, 1988, 1997b; Ferguson & Selling, 1985; Haast, et al., 2005; K. Johnson, 1999; Mellen, et al., 2000; Ransley & Ingram, 2001; Reichardt & Lennhoff, 2003).

Of the asset related deductions from GOP that are noted in Table 7.2, making a charge for debt service and return on equity both appear to lay the basis for greater owner-operator capital expenditure goal congruency relative to an FF&E reserve allocation linked deduction. This is because they both represent an explicit charge for the full cost of any capital outlays made, signifying a capacity to induce operators to minimise the owner’s capital outlay.

Eyster (1988, 1993) has observed some hotel operators remunerated according to a hybrid approach providing them with the option of receiving a base fee or an incentive fee, whichever is greater. Eyster’s findings, summarised in Table 7.3, suggest this optional form of operator reimbursement is not common. The fee bases noted in Table 7.3 do not warrant any further examination as none constitute novel approaches that have not already been discussed above.

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2 In the interests of parsimony, we have assumed that the $1,000 increase in revenue has not resulted in a change in profit. This simplifying assumption does not affect the rationale outlined.

3 It is notable that widely deployed long-term loan restrictive covenants impose FF&E reserve contribution requirements on hotel owners as a means of protecting lender interests.

4 It should be noted that charges for debt and equity appear to be little used outside the U.S. Discussions with a specialist in the preparation of hotel management contracts in Australia indicate that it would be very rare for capital employed charges (whether relating to debt or equity) to be included in the calculation of the profit basis used to determine an operator’s incentive fee.
### TABLE 7.3
Prior research into the incidence of options in operator fee determination

<table>
<thead>
<tr>
<th>Author</th>
<th>Geographic focus</th>
<th>Contracts analysed</th>
<th>% incidence</th>
<th>Driver of base fee and typical amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eyster (1988)</td>
<td>U.S. (58 contracts) &amp; international (19 contracts)</td>
<td>77</td>
<td>9.1</td>
<td>Whichever is greater of gross revenue (3 – 4%) or GOP (10 – 20%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1.3</td>
<td>Whichever is greater of fixed fee (US$36,000 - $60,000), or gross revenue (3%) and GOP (8%).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>1.3</td>
<td>Whichever is greater of a fixed fee (US$35,000 - $75,000) or gross revenue (3%) or GOP (15%)</td>
</tr>
<tr>
<td>Eyster (1993)</td>
<td>U.S.</td>
<td>17</td>
<td>5.9</td>
<td>Whichever is greater of gross revenue (3%) or GOP (10%)</td>
</tr>
</tbody>
</table>
A second dimension of the management contract that draws on accounting metrics to promote owner-operator goal alignment concerns the identification of a set of performance standards which, if not met, can be invoked by an owner as grounds for terminating the contract with a poorly performing operator (Dutta, 2003; Haktanir & Harris, 2005). When drawing up a management contract, the contracting parties would have to agree on minimum performance levels, for the selected measures.

Despite the commonplace nature of performance-based termination provisions, as a balance needs to be struck between an operator’s quest for flexibility to manage unforeseen market circumstances and an owner’s quest for meaningful performance standards, this aspect of contracting can often be a source of significant owner-operator conflict (Beals & Denton, 2005). Despite this, the deployment of minimum performance standards in hotel management contracting is expected to increase commensurate with rising hotel operator competition levels (Eyster, 1997b; Goddard & Standish-Wilkinson, 2002; P. J. Harris & Mongiello, 2001; Rainsford, 1994). It is widely noted, however, that exclusive use of performance measures is unlikely to curb potential dysfunctional operator behaviour, because owners have limited capacity to extract all private information pertaining to performance (Baiman, 1990; Baiman, Evans, & Noel, 1987; Magee, 1980).

Performance standard clauses typically take into consideration the effect of economic cycles, so that circumstances that are beyond the operator’s control do not adversely affect an operator’s contractual standing (Crandell, et al., 2004). Some contracts also include stand-aside provisions that require the operator to forego incentive fees until a predetermined level of GOP is achieved (Goddard & Standish-Wilkinson, 2002). This stand-aside is usually structured as a loan repayable to the operator out of profits achieved in later periods (Schlup, 2004). There is a current trend away from stand-aside provisions, however, unless the operator is compensated with higher incentive fees for taking on this greater risk (Bader & Lababedi, 2007). The findings of prior empirical research appraising the nature and incidence of operator performance measures are summarised in Table 7.4.
<table>
<thead>
<tr>
<th>Author</th>
<th>Geographic focus</th>
<th>Contracts analysed</th>
<th>Proportion of hotels identifying criteria for management contract termination</th>
<th>Performance measure</th>
<th>Performance threshold requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eyster (1988)</td>
<td>U.S. (58 contracts) &amp; international (19 contracts)</td>
<td>77</td>
<td>36% of chain operators that have no equity invested - 18% of chain operators with equity invested - 14% of international operators</td>
<td>GOP (most common)</td>
<td>Actual GOP is compared against the performance of other competitive properties.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Cash flow after debt service (common)</td>
<td>Suitability of measure determined with reference to a comparison of projected and actual inflation rates for the period under consideration.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Cash flow after debt service and return on equity (less common)</td>
<td>Suitability of measure determined with reference to a comparison of projected and actual inflation rates for the period under consideration.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Occupancy percentage (seldom)</td>
<td>Actual occupancy percentage is compared against the performance of other competitive properties.</td>
</tr>
<tr>
<td>Eyster (1993)</td>
<td>U.S.</td>
<td>17</td>
<td>37% of chain operators - 32% independent operators</td>
<td>GOP</td>
<td>Agreed-upon three-to-five-year annual budgeted projections of GOP compared to actual GOP each year.</td>
</tr>
<tr>
<td>Eyster (1997b)</td>
<td>U.S.</td>
<td>18</td>
<td>58%</td>
<td>GOP</td>
<td>Agreed-upon eight-to-ten-year annual budgeted projections of GOP compared to actual GOP each year.</td>
</tr>
<tr>
<td>Barge and Jacobs (2001)</td>
<td>Asia-Pacific (Australia included)</td>
<td>28</td>
<td>Did not specify.</td>
<td>GOP</td>
<td>Agreed-upon annual projections of budgeted GOP compared to actual GOP each year (actual GOP must typically be 80% or more of budgeted GOP for performance to be deemed satisfactory).</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>50</td>
<td>62.1%</td>
<td>GOP</td>
<td>Agreed-upon annual projections of budgeted GOP compared to actual GOP each year (actual GOP compared to the trading results of three comparable hotels).</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>24</td>
<td>Did not specify.</td>
<td>GOP</td>
<td>Agreed-upon annual projections of budgeted GOP compared to actual GOP each year.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>NOP</td>
<td>Agreed-upon annual projections of budgeted NOP compared to actual NOP each year.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>RevPAR</td>
<td>RevPAR compared to annual results of a competitive set.</td>
</tr>
<tr>
<td>Goddard and Standish-Wilkinson (2002)</td>
<td>Middle-East</td>
<td>9</td>
<td>55%</td>
<td>GOP</td>
<td>Agreed-upon annual projections of budgeted GOP compared to actual GOP each year.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Negotiated dollar target</td>
<td>Negotiated dollar target is set down for each year of the agreed period.</td>
</tr>
<tr>
<td>Region</td>
<td>Percentage</td>
<td>Base figure</td>
<td>GOP (most common)</td>
<td>RevPAR (less common)</td>
<td></td>
</tr>
<tr>
<td>-------------------------------</td>
<td>------------</td>
<td>-------------</td>
<td>--------------------------------------------</td>
<td>----------------------------------------</td>
<td></td>
</tr>
<tr>
<td>Asia-Pacific (Australia included)</td>
<td>57.1%</td>
<td>agreed upon annual projections of budgeted GOP compared to actual GOP each year. (Actual GOP must typically be 80% or more of budgeted GOP for performance to be deemed satisfactory.)</td>
<td>RevPAR is typically relative to a competitive set, market, or even a particular property, which is often a hotel managed by the same hotel operator.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Europe</td>
<td>50+%</td>
<td>agreed upon annual projections of budgeted GOP compared to actual GOP each year. (Actual GOP must typically be 80% or more of budgeted GOP for performance to be deemed satisfactory.)</td>
<td>RevPAR is typically relative to the average of a competitive set.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Americas</td>
<td>57.1%</td>
<td>no further details given.</td>
<td>Must achieve a percentage of budgeted NOP</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Thailand</td>
<td>Unspecified</td>
<td>agreed upon annual projections of budgeted GOP compared to actual GOP each year.</td>
<td>RevPAR is typically relative to a comparison of competitive properties in the same local market area.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The only measures documented in Table 7.4 that have not already been considered in the earlier discussion are occupancy and revenue per available room (RevPAR). The relative merits of each are commented on in the hospitality management accounting normative literature (e.g. Jagels, 2007; Schmidgall, 2006). With respect to their implications for capital expenditure decision making, similar to the rationale already outlined, occupancy and RevPAR both suffer from no recognition accorded to capital outlay. If appraised on RevPAR and occupancy, an operator would have an inducement to rank a $50,000 capital expenditure opportunity that results in a 2% increase in occupancy and $5 increase in RevPAR behind a $1,000,000 outlay that results in a 3% increase in occupancy and $6 increase in RevPAR. Although the first option can be expected to represent a higher return on investment, of the two options, the first yields the lower occupancy and RevPAR. This highlights the use of further performance measures that are deficient in promoting owner-operator capital expenditure goal congruence. Emphasis on occupancy and RevPAR performance measures can also be expected to raise the priority attached by an operator to accommodation related capital expenditures as opposed to expenditure on other hotel facets such as restaurant and bar activities.

Where an operator is performing poorly, the only other termination option for an owner is to invoke termination without a cause provisions. Prior empirical research findings concerned with appraising the incidence and nature of termination without a cause management contract provisions are summarised in Table 7.5.
<table>
<thead>
<tr>
<th>Author</th>
<th>Geographic region</th>
<th>Contracts analysed</th>
<th>Type of operator</th>
<th>Incidence % adopting</th>
<th>Penalty fee in relation to management fees (base and incentive)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eyster (1988) (^3)</td>
<td>U.S. (58 contracts) &amp; international (19 contracts)</td>
<td>77</td>
<td>Branded</td>
<td>30%</td>
<td>At any time: 3 – 5 years After a predetermined period: After 6 months: 3 – 5 years After 1 to 2 years: 3 – 5 years After 3 to 4 years: 2 – 4 years After 5 years: 1 – 3 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Non-branded</td>
<td>53%</td>
<td>At any time: 1 – 5 years After a predetermined period: After 6 months: 1 - 5 years After 1 to 2 years: 3 years After 3 to 4 years: 2 years After 5 years: 1 year</td>
</tr>
<tr>
<td>Eyster (1993)</td>
<td>U.S.</td>
<td>17</td>
<td>Branded</td>
<td>22%</td>
<td>After a predetermined period: First 3 years - cannot terminate After 3 to 6 years: 4 years After 7 to 10 years: 3 years After 11 years: 2 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Non-branded</td>
<td>31%</td>
<td>After a predetermined period: First 1 to 3 years - cannot terminate After 3 to 5 years: 2 years After 6 years: 1 year</td>
</tr>
<tr>
<td>Eyster (1997b)</td>
<td>U.S.</td>
<td>18</td>
<td>Branded</td>
<td>23%</td>
<td>After a predetermined period: First 1 to 3 years - cannot terminate Years 2 to 4 onwards: 2 to 4 years</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Non-branded</td>
<td>68%</td>
<td>At any time: 0.5 to 2 years After a predetermined period: First 1 to 3 years - cannot terminate Years 2 to 4 onwards: 0.5 to 2 years</td>
</tr>
<tr>
<td>Johnson (1999)</td>
<td>U.S.</td>
<td>50</td>
<td>Branded and non-branded</td>
<td>33%</td>
<td>At any time: Most common 2.5 years</td>
</tr>
<tr>
<td>Barge and Jacobs (2001)</td>
<td>Asia-Pacific (Australia included)</td>
<td>50</td>
<td>Branded and non-branded</td>
<td>36%</td>
<td>Unspecified</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>24</td>
<td>Branded and non-branded</td>
<td>31%</td>
<td>Unspecified</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>28</td>
<td>Branded and non-branded</td>
<td>25%</td>
<td>Unspecified</td>
</tr>
<tr>
<td>Haast, Dickson, and Braham (2005)</td>
<td>Asia-Pacific (Australia included)</td>
<td>28</td>
<td>Branded and non-branded</td>
<td>25%</td>
<td>Unspecified</td>
</tr>
<tr>
<td></td>
<td>Europe</td>
<td>29</td>
<td>Branded and non-branded</td>
<td>17%</td>
<td>Unspecified</td>
</tr>
<tr>
<td></td>
<td>Americas</td>
<td>28</td>
<td>Branded and non-branded</td>
<td>23%</td>
<td>Unspecified</td>
</tr>
</tbody>
</table>

\(^3\) Results of independent operators where their owner is in foreclosure omitted.
Table 7.5 highlights that around one-third of management contracts feature termination without a cause provisions. Consistent with the challenge of activating operator performance measures, termination without a cause provisions are becoming increasingly difficult to invoke because they contain many qualifications and caveats (Dickson, 2007). In the Asia-Pacific region, for example, Dickson et al. (2008) claim that it is becoming almost impossible to terminate an operator, even if they clearly and demonstrably lack the ability to profitably operate the hotel. The fact that it is becoming harder for owners to invoke management contract termination clauses underscores the importance of ensuring that a negotiated management contract is conducive to a high degree of owner-operator goal alignment. Management contract termination impediments combined with deficient owner-operator goal congruence signifies a high propensity for protracted hotel operational decisions that are inconsistent with owner interests.

7.3 Return on investment and residual income as alternative determinants of operator fees

The foregoing analysis has highlighted widespread use of hotel operator remuneration bases that appear deficient with respect to promoting owner-operator capital expenditure goal congruency. We now turn to consider alternative performance measures that, a priori, represent inducement bases more consistent with promoting owner-operator capital expenditure goal congruency.

Generally accepted finance practice holds that the preferred investment appraisal criterion is NPV and that capital expenditure proposals are justifiable if they yield a projected positive NPV (Butler, et al., 1993; J. D. Payne, et al., 1999). Formulation of a NPV calculation requires the provision of projected cash flows. NPV would not be a good basis for determining hotel operator management fees, however. This is because operator management fees need to be based on an objectively verifiable performance measure. Monitoring past achievements involves much less subjectivity than the development of projected cash flow estimates. So although NPV is the preferred approach for evaluating capital expenditure proposals, it does not lend itself to gauging a hotel operator’s performance.

Two measures of past performance that give recognition to the amount of investment involved in generating a return and are widely discussed in the management accounting
literature are return on investment (ROI) and residual income (RI) (Anthony & Govindarajan, 2007; Langfield-Smith, Thorne, & Hilton, 2003). From examples already provided, it is apparent that ROI is calculated by dividing profit by assets employed to generate the profit (Danfy, 1975). Accordingly, ROI constitutes a ratio, not an absolute dollar amount. RI is calculated as profit minus an imputed charge for capital employed. The imputed charge is generally linked to the cost of capital (Langfield-Smith, et al., 2003).

The major benefit of ROI is that the agent is discouraged from excessive investment in assets. Further advantages of ROI include: (1) it reflects anything that affects the financial statements; (2) it is easy to calculate, simple to understand, and is meaningful in an absolute sense; (3) it can be applied to any unit within an organisation responsible for profitability, regardless of the size or type of the business; and (4) as ROI data is typically available for competitors, it can be used as a basis for comparison (Anthony & Govindarajan, 2007). A major disadvantage of ROI is that it can encourage agents to defer asset replacement and also discourage agents from investing in some capital projects that are viable from an owner’s perspective, as will be seen below.

RI has been widely promoted as a measure that averts some of ROI’s shortcomings (see Anthony & Govindarajan, 2007; Christensen, Feltham, & Wu, 2002; Dutta & Reichelstein, 2002; Ittner & Larcker, 1998; Langfield-Smith, et al., 2003; Rogerson, 1997). RI’s improvement over ROI stems from its formula containing an important piece of data that is absent from the ROI formula, i.e., the organisation’s required rate of return on invested capital (Langfield-Smith, et al., 2003).

In a hotel management investment decision making context, Guilding (2002, pp. 122-124) demonstrates how RI represents a preferred incentive basis to ROI. He considers two hotels that are part of the same chain that is seeking a 10% target ROI. Hotel A is earning a $20,000 return on a $500,000 investment (ROI of 4%). Hotel B is earning a $90,000 return on a $500,000 investment (ROI of 18%). If performance measurement is ROI based, Hotel A would have an incentive to purchase an asset costing $200,000 that would increase annual

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6 Forms of residual income often appear under various names such as abnormal earnings (Ohlson, 1995) or Economic Value Added (EVA®), which is a technique popularised by the consulting firm Stern Stewart & Co (Anthony & Govindarajan, 2007; Biddle, Bowen, & Wallace, 1997; Chen & Dodd, 1997; J. Wallace, 1997).

7 A detailed description of how the imputed interest rate is estimated is beyond the scope of this study but can be found in finance textbooks such as Peirson, Brown, Easton and Howard (2006); and Bishop, Crapp and Twite (2004).
profit by $18,000, as the hotel’s ROI would increase from 4% to 5.4% ($38,000 ÷ $700,000 \times 100). Also, Hotel B would have an incentive to sell an asset that generates $21,600 for its $180,000 book value, as the hotel’s ROI would increase from 18% to 21.4% ($68,400 ÷ $320,000 \times 100). The flaw in the ROI incentive becomes apparent when it is recognised that the hotel chain is preparing to buy an asset that will earn a 9% ROI ($18,000 ÷ $200,000) while at the same time selling a second asset earning a higher ROI of 12% ($21,600 ÷ $180,000). This problem is averted if RI maximisation is adopted as the performance measurement criterion. If Hotel A were to make the $200,000 asset purchase, its RI would drop from -$30,000 ($20,000 – (0.1 \times $500,000)) to -$32,000 ($38,000 – (0.1 \times $700,000)). If Hotel B were to make the $180,000 asset sale, its RI would drop from $40,000 ($90,000 – (0.1 \times $500,000)) to $36,400 ($68,400 – (0.1 \times $320,000)). The drop in the two hotels’ respective RIs signify that neither should make the asset changes under consideration.

When applying the RI algorithm, any investment that exceeds an organisation’s required rate of return yields a positive RI. As a result, RI motivates managers to maximise profits from the resources that they have at their disposal and to only invest in additional resources when the investment will produce an adequate return (Anthony & Govindarajan, 2007).

It was noted earlier that finance practice holds that the preferred investment appraisal criterion is NPV. It is noteworthy, therefore, to recognise that RI, considered over the long term, approximates to NPV. Using RI to evaluate management performance can be expected to promote goal congruency, because the information that is required for NPV and IRR converges (considered over the long term, accruals based differences between cash flows used in NPV calculations, and profit which is used in RI calculations, disappear). We can thus conclude that maximising RI over time approximates to maximising firm value.

Imagine a hotel operator is considering which of two mutually exclusive potential investment opportunities, Project A or Project B, it will promote to the owner of a hotel it manages. Project A will require an initial investment of $1,000,000 and Project B will require an initial investment of $4,000,000. The projected revenue and profit projections associated with the two investment alternatives are outlined in Table 7.6 below.
TABLE 7.6  
Calculation of operator management fees:  
Comparison of traditional management fee basis with residual income fee basis

<table>
<thead>
<tr>
<th></th>
<th>Project A</th>
<th></th>
<th>Project B</th>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Revenue</td>
<td>Gross operating profit</td>
<td>Revenue</td>
<td>Gross operating profit</td>
</tr>
<tr>
<td>Year 1</td>
<td>$500,000</td>
<td>$200,000</td>
<td>$800,000</td>
<td>$320,000</td>
</tr>
<tr>
<td>Year 2</td>
<td>$500,000</td>
<td>$200,000</td>
<td>$800,000</td>
<td>$320,000</td>
</tr>
<tr>
<td>Year 3</td>
<td>$500,000</td>
<td>$200,000</td>
<td>$800,000</td>
<td>$320,000</td>
</tr>
<tr>
<td>Year 4</td>
<td>$500,000</td>
<td>$200,000</td>
<td>$800,000</td>
<td>$320,000</td>
</tr>
<tr>
<td>Year 5</td>
<td>$500,000</td>
<td>$200,000</td>
<td>$800,000</td>
<td>$320,000</td>
</tr>
</tbody>
</table>

Based on a typical traditional fee incentive of 3% of gross revenue and 10% of gross operating profit, we find that the operator would prefer Project B as it would result in an increase in the operator fee revenue of $56,000 (3% of $800,000 + 10% of $320,000) per annum for the five years of Project B’s life. This is more than the $35,000 (3% of $500,000 + 10% of $200,000) projected incremental fee revenue that would result if Project A were pursued.

On an ROI and RI basis, it can be seen than project A provides the higher return, however. Project A provides an ROI of 20% ($200,000 ÷ $1,000,000 X 100) per annum and Project B provides an ROI of 8% ($320,000 ÷ $4,000,000 X 100) per annum. If the hotel owner imputes a 10% required rate of return (based on its cost of capital) charge when calculating RI, we see that Project A has a positive RI of $100,000 ($200,000 – (0.1 X $1,000,000)) per annum and Project B has a negative RI of $80,000 ($320,000 – (0.1 X $4,000,000)) per annum.

If the operator were to be paid an incentive that is set at (say) 40% of RI, pursuit of Project A would result in an increase in the operator’s fee revenue of $40,000 (40% of $100,000) per annum and pursuit of Project B would result in a decrease in the operator’s fee revenue of $32,000 (40% of -$80,000) per annum.

A comparison of the projected ROIs for the two projects and the fact that Project B fails to satisfy the owner’s 10% required rate of return provides a persuasive case that the hotel owner would prefer to take Project A. Capital expenditure goal congruency is promoted if the operator is remunerated based on RI (Project A has the higher RI), but it is not promoted if
the operator is remunerated based on a revenue and profit incentive, as the operator would have an incentive to promote Project B.

The simulated exercise above demonstrates how RI represents a performance measurement basis that promotes a higher degree of owner-operator capital expenditure goal congruency relative to traditional hotel operator fee bases that are tied to revenue and profit.

Analysis of hotel management contracts in the U.S. provides some support for the view that RI represents a preferred basis for determining hotel operator remuneration. Eyster’s (1993) study cites examples of contracts where the basis for the remuneration fee is GOP (or cash flow) adjusted for items such as debt service and return on equity. Adjusting profit for debt service can be seen as a ‘partial RI’ measure for although it embodies a charge for debt capital, no charge is made for equity funding. For the 5.9% of contracts examined by Eyster where the operator remuneration is based on cash flow after debt service and return on equity, we have a closer approximation to RI. This is because the measure involves a charge made for all long-term capital funding (i.e. equity and debt). While this signifies the existence of some management contracts promoting a better alignment of owner-operator capital expenditure interests, this improved alignment will be largely negated if this type of incentive fee is combined with a base fee determined by gross revenue. This issue is noteworthy as Eyster (1993) found a high proportion of contracts where the base fee is determined by gross revenue.

Although this suggests using RI as a basis for determining operator fees, it should be noted that it is not a measure devoid of shortcomings. RI is a financially denominated measure that is calculated from accrual accounting numbers. Performance measures that are based on accounting numbers are widely criticised for instilling a short-termist outlook (Ezzamel, 1992; Ezzamel & Hart, 1989; Rappaport, 1986). In light of this, many commentators suggest combining financial and non-financial performance measures in an attempt to better align the interests of principals and agents (Aggarwal, 1991; Kakati & Dhar, 1991; Slagmulder & Bruggeman, 1992).  

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8 Non-financial performance measures, for example, can include market share (Morishima, 1982; Prestowitz, 1988; Tsurui, 1984; Van Wolferen, 1989); innovativeness (Goldsmith & Clutterbuck, 1984); market standing (J. Saunders & Wong, 1985); efficiency / productivity, product quality, customer satisfaction, employee satisfaction (Ittner, et al., 1997), and others.
A further shortcoming of using ROI or RI relates to Healy’s (1985) bonus plan hypothesis. Healy (1985) explains how the remuneration conditions existing between a principal and agent can cause the agent to make profit increasing or decreasing accounting policy choices. If ROI or RI is used to incentivise an operator, and profit in a particular year is negative, the operator may be induced to ‘take a bath’ by selectively expensing any potential future capital expenditure in the current period in order to reduce capital charges assigned to future years. Given the high asset base associated with hotels, there would appear to be a considerable potential to manipulate the period in which substantial expenses are charged. Generally Accepted Accounting Principles (GAAP) and hotel management contracts provide little guidance resolving the issue of how to differentiate between asset related expenditure that is to be expensed or capitalised (Schmidgall, Damitio, & Singh, 1997). Research examining Healy’s (1985) hypothesis provides equivocal results, however. Studies supporting Healy’s hypothesis include (see Bernard & Skinner, 1996; Dechow, et al., 1995; Holthausen, et al., 1995; J. Jones, 1991; Kaplan, 1985; McNichols & Wilson, 1988; Schipper, 1989). Research providing conflicting evidence includes (see DeFond & Park, 1997; Gaver, et al., 1995).

While the discussion in this section has been conducted in the context of a quest for improved bases of hotel operator fee determination, it is also pertinent to identifying appropriate performance measure thresholds that can be invoked by an owner as grounds for contract termination. Based on the rationale outlined, it would appear to be in owners’ interests to require operators to meet performance thresholds stated in terms of ROI or RI.

7.4 Conclusion

This chapter’s primary contribution is to provide a systematic examination of the shortcomings of conventional performance measures used to determine hotel operator fees and to advance the case that ROI and residual income represent alternative performance bases that would result in heightened levels of owner-operator goal alignment. The rationale provided offers considerable potential to stimulate further debate into hotel owner-operator contracting and to change the structure of operator fee incentive terms widely used in hotel management contracting. The chapter can also be seen as representing a particular contribution to the application of agency theory in the hotel management context.
The next chapter describes the research methodology adopted and will outline the two research methods adopted in greater detail. These research methods comprise the conduct of face-to-face interviews followed by a mailed questionnaire survey.
CHAPTER 8
THE RESEARCH METHODOLOGY

8.1 Introduction

The past seven chapters have provided a detailed review of the literature most pertinent to the study. This chapter describes the research methodology adopted and will explain the two research methods applied in greater detail. These research methods involve the conduct of face-to-face interviews followed by a mailed questionnaire survey. This sequence of empirical data collection provides tremendous potential for enhancing the understanding and interpretation of results obtained from statistical analyses (Hodgkinson & Payne, 1998; Wilk, 2001). Such an approach can also allow for a triangulation of research methods and the adoption of a mixed methods research paradigm (Edmondson, 1996; Hayne & Pollard, 2000; Judge, Thoresen, Bono, & Patton, 2001; Shaffer & Harrison, 2001; Trevelyan, 2001). Adopting a mixed methods research paradigm answers the call for more management accounting research to be carried out in such a manner (see Birnberg, et al., 1990).

The remainder of this chapter is organised as follows. The following section provides an overview of the mixed methods research paradigm as well as a discussion of the strengths and weaknesses of both face-to-face interviews and mailed questionnaire surveys. Following this, the subsequent section outlines issues associated with reliability and validity and how attempts have been made to maximise these in the two research methods adopted in the study. The final section provides a concluding commentary for the chapter.

8.2 Mixed methods research

When conducting research in the social sciences, researchers generally have a choice of three broad research paradigms: (1) qualitative; (2) quantitative; and (3) mixed methods. Creswell (2003) explains that qualitative methods make use of strategies such as ethnographies, grounded theory studies, case studies and narratives. Their intention is to develop themes and construct a theory or pattern so they are usually based on a constructivist or advocacy / participatory perspective. Quantitative research methods typically use experiments and surveys to collect data and test theories relating to cause and effect relationships. Quantitative research is typically labelled as ‘postpositivist’ because it is determinist, reductionist and uses
empirical observation and measurement. Mixed methods research makes use of both qualitative and quantitative approaches and is founded on pragmatism, which is concerned with ‘what works’ in addressing research problems and recognises that the values of the researcher influence the interpretation of results (Creswell, 2003). A major benefit of mixed methods research is that it allows for a triangulation of research methods, which can result in enhanced and new lines of thinking, and confirmation and elaboration in management accounting research because the weaknesses of one approach can be compensated for by the strengths of the other approach (Birnberg, et al., 1990; Miles & Huberman, 1994; Rossman & Wilson, 1984, 1991). Further, the researcher is free to choose between inductive or deductive reasoning, depending on the questions that need to be answered (Krathwohl, 1993). Table 8.1 highlights the way in which mixed methods research deviates from pure qualitative or quantitative approaches.
<table>
<thead>
<tr>
<th>Alternative knowledge claim positions</th>
<th>Quantitative</th>
<th>Qualitative</th>
<th>Mixed Methods</th>
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<td>Determination</td>
<td>Understanding</td>
<td>Pragmatism</td>
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<tr>
<td>Post-positivism</td>
<td>Reductionism</td>
<td>Multiple participant meanings</td>
<td>Consequences of actions</td>
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<td>Empirical observation and measurement</td>
<td>Social and historical construction</td>
<td>Problem-centred</td>
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<td>Theory generation</td>
<td>Theory generation</td>
<td>Pluralistic</td>
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<td>Advocacy/Participatory</td>
<td>Advocacy/Participatory</td>
<td>Real-world practice</td>
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<td></td>
<td>Reductionism</td>
<td>Multiple participant meanings</td>
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<td>Narratives</td>
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<td>Concurrent</td>
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<td></td>
<td>Predetermined</td>
<td>Ethnographies</td>
<td>Transformative</td>
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<td>Research methods</td>
<td>Instrument based questions</td>
<td>Grounded theory</td>
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<td></td>
<td>Performance data, attitude data, observational data, and census data</td>
<td>Case studies</td>
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<td>Statistical analysis</td>
<td>Emerging methods</td>
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<td>Open-ended questions</td>
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<tr>
<td></td>
<td>Instrument based questions</td>
<td>Interview data, observation data, document data, and audiovisual data</td>
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<td></td>
<td>Performance data, attitude data, observational data, and census data</td>
<td>Text and image analysis</td>
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<td></td>
<td>Statistical analysis</td>
<td>Both determined and emerging methods</td>
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<td>Predetermined</td>
<td>Both open-ended and closed-ended questions</td>
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<td>Instrument based questions</td>
<td>Multiple forms of data drawing on all possibilities</td>
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<td>Performance data, attitude data, observational data, and census data</td>
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<td>Statistical analysis</td>
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</table>

Source: Adapted from Creswell (2003, pp. 6-18)
8.2.1 Strengths and weaknesses of face-to-face interviews

Face-to-face interviews have a wide array of strengths including: (1) interviews can provide an in-depth study of real-world phenomena through direct contact with organisational participants (Aherns & Dent, 1998; Bailey, 1996; Huber & Van de Ven, 1995; Yin, 2002); (2) interviews can help go beyond the question of ‘what’ (identification) and ‘how’ (explanation) and into the question of understanding ‘why’ certain phenomena exist (Merchant & Van der Stede, 2006); (3) interviews can facilitate the generation of ‘relevant’ theories, which are especially effective for building theory (Bennis & O’Toole, 2005); (4) interviews can facilitate immediate situational responses from interviewees (Lang & Heiss, 1998); (5) interviews can allow for high quality and more accurate inferences (Abernethy, Chua, Luckett, & Selto, 1999; A. Atkinson & Shaffir, 1998; Brewer & Hunter, 1989; Greene & Caracelli, 1997); (6) interviews can give great opportunity for a researcher to probe deeply to uncover new clues and dimensions of a problem, and to secure vivid, accurate inclusive accounts that are based on personal experience (R. G. Burgess, 1982); (7) interviews can facilitate greater communication between the interviewer and the interviewee, which allows the interviewer the flexibility to deviate from pre-formulated agendas and to probe areas of vagueness and to immediately check information (Babbie, 1989; Lang & Heiss, 1998); and (8) interviews can allow secondary questions to develop from non-verbal cues given by an interviewee, such as facial expressions and inflection (Easterby-Smith, Thorpe, & Lowe, 2002).

Face-to-face interviews do, however, have weaknesses. Perhaps the most troublesome weakness is interviewer bias, which occurs when an interviewer imposes their own opinions and attitudes on the interviewee and on how the answers are interpreted. This can affect the information collected and the analysis of findings reported (Lillis, 1999). Although bias can never be overcome completely, steps can be taken to minimise the potential of this effect (M. Saunders, Lewis, & Thornhill, 2003). A common step to reduce bias is for the researcher to use some open-ended questions so as to allow the interviewee to answer in their own words, without any prompts from the interviewer (Easterby-Smith, et al., 2002). The interview questions themselves, how they are worded and their phrasing, are also of critical importance in reducing bias (Babbie, 1989). For example, the way in which a question is asked, or the context in which it is asked, can cause an interviewee to feel pressure to omit the most relevant answer and instead give the interviewer the answer they were looking for (Babbie,
1989). It is also important that the interviewer does not over-elaborate when asking questions and is aware that the interviewee may not wish to answer a question (S. L. Payne, 1973). To address interviewer bias concerns, the researcher paid careful attention to the issues outlined above, which are outlined in greater detail in Chapter 9.

The skills of the interviewer are also typically developed with practice (Babbie, 1989; Easterby-Smith, et al., 2002). To address this concern, both the researcher and his supervisor attended the initial six interviews. This enabled the researcher to gain valuable experience and practice in the art of interviewing from his more experienced supervisor. Baxter and Chua (1998) also explain that in face-to-face interviews the interviewer must be aware of the impact that first impressions can have on the interviewee, as these can bear on the direction and content extracted from an interviewee. To address this concern, the researcher (and where applicable, his supervisor) conducted his dealings with the interviewees in a professional manner. This included mailing interview information packages to potential interviewees. This package contained a flyer printed on high quality colour paper indicating that endorsement for the study had been obtained from three leading hotel consultancy companies (see appendix A) and a cover letter signed by the researcher and his supervisor (see appendix B) in order to seek their participation in the project. Any subsequent telephone or email contact was conducted in a professional and impartial manner. The researcher (and where applicable, his supervisor) always dressed appropriately for interviewing in order to portray a professional image.

8.2.2 Strengths and weaknesses of mailed questionnaire surveys

Although questionnaires can be administered either face-to-face, over the telephone, by mail, or by email, in this study, the choice to mail the questionnaire was taken for the following reasons: (1) mailed questionnaire surveys are commonly accepted and have been used prolifically in management accounting research over the last twenty-five years; (2) mailed questionnaires are the most widely used data collection technique in surveys; (3) it is possible to obtain a sample large enough to reduce sampling error to acceptable levels; (4) mailed questionnaires can be sent to a wide geographical area; (5) respondents do not have to rush and can consult personal records for further information; (6) mailed questionnaires can offer anonymity; and (7) mailed questionnaires can be effective where the target group has a strong interest in the topic and are well educated (Alreck & Settle, 1995; Dillman, 2002; Easterby-
Mailed questionnaire surveys, however, do have some weaknesses and one of the most troublesome is that there can sometimes be a low response rate (Alreck & Settle, 1995; Dillman, 2002; Easterby-Smith, et al., 2002; Gillham, 2000; Neuman, 2003; Sproull, 1995; S. M. Young, 1996). Concerns over low response rates can, however, be mitigated through excellent questionnaire design (M. Smith, 2003) and mailout procedures (Roberts, 1999; S. M. Young, 1996). In this study, rigorous pilot testing helped to alleviate concerns regarding the quality of the design of the questionnaire. Two mailings of the questionnaire were also carried out to address the mailout concerns.

8.3 Reliability and validity

The combination of face-to-face interviews and a mailed questionnaire survey can add to the reliability and validity of the information gathered in a study (Abernethy, et al., 1999; Aram, Salipante, & Kauf, 1987; Miles & Huberman, 1994; Sutton & Rafaeli, 1998; Yin, 1989). Perfect reliability and validity, however, are practically impossible to achieve (Neuman, 2003). The following sections investigate reliability and validity separately in the context of the interview and survey phases of research undertaken.

8.3.1 Reliability

Reliability is concerned with dependability and consistency and if a study has high reliability then the measurement process results in the same thing being repeated or recurring under identical or very similar conditions (Brownell, 1995; Neuman, 2003). A study would have low reliability, however, if the measurement process resulted in erratic, unstable or inconsistent results (Neuman, 2003). Reliability is also a necessary pre-condition for validity (Nunnally, 1976). Different research methods require different considerations with regard to reliability, which are outlined in the following sections.
8.3.1.1 Reliability in face-to-face interviews

To strengthen the reliability of the qualitative element of this research, all procedures and data collection methods were well documented in Chapter 9 so that processes and analysis could be preserved, which can enhance the integrity of both the data and the logic underlying the conclusion (A. Atkinson & Shaffir, 1998; Brownell, 1995).

8.3.1.2 Reliability in questionnaire surveys

Reliability where quantitative research methods are adopted are more complex because there are three types of reliability: (1) stability reliability; (2) representative reliability; and (3) equivalence reliability (Neuman, 2003). Stability reliability addresses the question of whether a measure delivers the same answer when applied in different time periods. Representative reliability addresses the question of whether a measure delivers the same answer when applied to different groups. Equivalence reliability addresses the question of whether a measure yields consistent results across different indicators. Within this study, as data was not gathered across different time periods or groups, both stability reliability and representative reliability are not applicable.

To improve equivalence reliability in a mailed questionnaire survey, Neuman (2003) suggests that four steps be taken, which include: (1) clearly conceptualising all constructs; (2) use a precise level of measurement; (3) use multiple indicators; and (4) use pilot tests.

To ensure that all constructs were clearly conceptualised for all variables, checks were carried out to determine if there were any pre-existing measures available. Where such checks failed to identify any pre-existing measures, consideration was given to adaptation of related pre-existing measures. Only where no pre-existing or related pre-existing measures could be located was a new measure developed. Rationale for all measures adopted in this study is provided in Chapter 11.

Hinkin (1995) explains that the level of measurement used should generate sufficient variance among respondents for subsequent statistical analysis and Likert-type scales that range from 3 points to 10 points can achieve this. Nunnally (1978, p. 521), however, comments that:
As the number of scale steps is increased from 2 up through 20, the increase in reliability is very rapid at first. It tends to level off at about 7, and after about 11 steps, there is little gain in reliability from increasing the number of steps.

Likert scalable questions were therefore assigned a seven-point scale. Where categorical data was collected, care was taken to allow measurement at the most precise level possible.

As outlined by Roberts (1999), multiple measures are more desirable than single-item measures. Many constructs, for example, are complex concepts and this complexity is better covered if more than one question is asked (Roberts, 1999). A number of related items can also help to increase reliability because a single question may be unreliable due to its wording (Roberts, 1999). Asking a number of related questions therefore minimises the risk of the wording of a question substantially affecting the answer (Roberts, 1999). Overall, multi-item measures are therefore more stable than single item measures (Neuman, 2003). In the current study, where possible, three or more measures were used to collect information in relation to a variable. Discussion of the development of measures related to variables under consideration in this study is provided in Chapter 11. Chapter 13 provides the results of factor analysis whereby an assessment is made concerning the degree to which multiple item measures coalesce around a particular variable. Finally, to address Neuman’s (2003) concern that pilot testing be carried out to enhance the reliability of a questionnaire survey, the questionnaire was piloted tested by a number of academics and practitioners. Details of this pilot testing are presented in Chapter 11.

8.3.2 Validity

Validity relates to truthfulness and is concerned with the match between a construct, or the way a researcher conceptualises an idea in a conceptual definition and a measure (Neuman, 2003). In essence, a study has high validity if an idea about reality fits with actual reality (Neuman, 2003). Validity is low, however, if there is a “poor fit between the constructs that a researcher uses to describe, theorise, or analyse the social world and what actually occurs in the social world” (Neuman, 2003, p. 179). Validity is typically more difficult to achieve than reliability, as one can never have complete confidence about validity, because some measures are more valid than others (Lillis, 1999). Different research methods, however, require different considerations with regard to validity (Neuman, 2003).
8.3.2.1 Validity in face-to-face interviews

Where the research method adopted is qualitative, the researcher will need to consider validity in terms of the bridge between a construct and the data (Neuman, 2003). In this way the researcher attempts to create a tight fit between their understanding, ideas and statements about the social world and what is actually occurring in it (Neuman, 2003).

To address validity in the face-to-face interviews, Atkinson and Shaffir (1998) explain that there are four common strategies that can be adopted. The first is that the researcher should identify clearly any preliminary hypotheses and/or the background or training that the researcher has taken into the study. This allows the reader to infer or anticipate what potential observation biases may have been introduced. In dealing with this point, the study’s research objectives were outlined in the introductory chapter. Further, both this chapter and the next discuss the background and training that the researcher has taken in connection with the study.

The second common strategy that Atkinson and Shaffir (1998, p. 61) advance to address issues of concern with regard to the validity of interviews is that “the researcher should identify clearly the mode of observation. This allows the reader to infer or anticipate how the observer may have influenced the process either through the act of observation itself or by participating in the process.” To attend to this issue, the interview findings chapters provide a detailed commentary of the way in which the interviews were conducted.

The third common strategy that Atkinson and Shaffir (1998, p. 61) advance to address issues of concern with regard to the validity of interviews is that “the researcher should develop alternative measures for the same phenomenon and show that both sets of data imply the same conclusions, a form of triangulation.” In addressing this point, a series of questions were asked in connection with the pursuit of each research objective.

Finally, the fourth common strategy that Atkinson and Shaffir (1998) advance to address issues of concern with regard to the validity of interviews is that the researcher should show evidence of having reviewed the material for accuracy and reasonableness. To attend to this concern, all interviews were fully transcribed. In addition, the NVivo software program was utilised to develop themes in the data. The recommendations of Baxter and Chua (1998) were
also followed, whereby direct quotes were included in the interview findings so as to convey rich, unbiased opinions, which can enhance the truthfulness of the narrative.

8.3.2.2 Validity in questionnaire surveys

Validity issues where quantitative research methods are adopted are complex because four different types of validity must be considered, which include: (1) face validity; (2) content validity; (3) criterion validity; and (4) construct validity (Neuman, 2003). Unless otherwise stated, the following paragraphs are based on the work of Neuman (2003) and explain each of the four dimensions of validity in greater detail.

Face validity is the easiest to achieve and is a judgement by the scientific community that the indicator really measures the construct. The chances of achieving high face validity were increased in this study through the provision of two detailed chapters regarding the development of the propositions (see Chapter 10) and the design of the questionnaire and related measures (see Chapter 11). In addition, the questionnaire was pilot tested, which facilitated determination that the measures used in the current study measured the correct constructs (Roberts, 1999).

Content validity addresses the question of whether the full content of a definition is represented in a measure. Content validity can be achieved by expanding a measure or narrowing a definition of a construct. Content validity is assessed in three steps: (1) specifying the content of a construct’s definition; (2) a sample is taken from all areas of the definition; and (3) a measure is developed so that it taps all parts of the definition (Neuman, 2003). To promote high content validity in the mailed questionnaire survey, a full explanation of what questions were asked and why is provided in Chapter 11.

Criterion validity is assessed by comparing a measure with another measure of the same construct in which the researcher has confidence. There are two types of criterion validity, concurrent validity and predictive validity. With regard to concurrent validity, two measures do not have to be perfectly associated but they should measure the same or a similar construct. Predictive validity would be high if it were possible to predict how people would score based on their specific characteristics. To achieve high concurrent criterion validity, consideration was given to pre-existing indicators that were already judged to be valid
through published research, so that measures could be developed that would be likely to yield similar results to pre-existing research. The recommendations of Hinkin (1995) were also followed whereby for any new measures established or adapted from previous studies, consideration was given to their theoretical domain. To address predictive criterion validity, care was taken when developing measures so that they would be mutually exclusive.

Construct validity addresses the question of ‘if the measure is valid, do the various indicators operate in a consistent manner?’ There are two types of construct validity, convergent validity and discriminant validity. Construct validity is high when multiple measures of the same construct hang together or operate in similar ways. Construct validity generally requires a definition to be clearly specified with conceptual boundaries. To improve construct validity, multi-item measures were developed wherever possible as the main threat to construct validity comes from bias and random error (Abernethy, et al., 1999). A number of related items can increase construct validity because a single question might be misinterpreted or misunderstood (Roberts, 1999). In this way, multi-item measures are more likely to preclude distortions from these cases (Roberts, 1999).

8.4 Conclusion

This chapter has described the research methodology adopted in this study. The chapter began by explaining that researchers can choose from three broad research perspectives. This study has adopted a mixed methods approach due to its use of two research methods: face-to-face interviews followed by the administration of a mailed questionnaire survey (Edmondson, 1996; Hayne & Pollard, 2000; Judge, et al., 2001; Shaffer & Harrison, 2001; Trevelyan, 2001). A major benefit of mixed methods research is that triangulation of research methods can be achieved whereby the weaknesses of one approach can be offset by the strengths of the other approach (Neuman, 2003). The chapter outlined the strengths and weaknesses of face-to-face interviews and mailed questionnaire surveys. Particular attention was given to explaining how the weaknesses of each research method can be mitigated. The final section provided a discussion of issues pertaining to reliability and validity where it was shown that different research methods typically require different ways of supporting the achievement of reliable and valid research findings. The discussion focused on identifying how both reliability and validity could be promoted in the two research methods adopted in the study. The next chapter presents the interview findings.
CHAPTER 9
INTERVIEW FINDINGS

9.1 Introduction

This chapter describes the findings of the interview phase of this study.1 Throughout the chapter, where appropriate, commentary from an agency theory perspective has been provided. For example, monitoring (or a lack of it) might influence General Manager behaviour. The remainder of the chapter is organised as follows. The first section provides details of the interview sample. The second section discusses the interview schedule. After this, each of the following seven sections present the interview findings in sequential order consistent with the thesis research objectives that were pursued in the interview phase of data collection.2 The final section provides a concluding commentary on the results of the chapter.

9.2 The interview sample

Interview data was collected from twenty key stakeholders in the Australian hotel industry over a six-month period from January 2007 to June 2007. All interviews were conducted in a face-to-face setting at the participants’ places of work. The interviewee group represented six different stakeholder groups, which comprised six asset managers, two hotel management contract lawyers, two hotel auditors, three hotel owners, four hotel general managers and three hotel financial controllers. Interviews were conducted in Sydney, Brisbane and the Gold Coast. Interviews varied in length from one and a half to three hours. Six short follow-up interviews of approximately fifteen minutes each were also carried out with three of the asset managers, two of the lawyers and one of the owners, in order to clarify a number of issues raised in the first round on interviewing. All of these follow up interviews were carried out in a face-to-face setting in Sydney. A number of additional informal discussions also took place with other parties who were interested in the subject of the research.

All interviews were tape recorded for transcription with the approval and consent of the interviewees and were fully transcribed. The full transcription of every interview was a

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1 A letter of ethics approval from Griffith University to conduct the interviews outlined in this chapter is presented in Appendix D.

2 The thesis has a total of eight research objectives, of which seven are pursued in the interview phase. Research objective five is only pursued in the survey phase of the study.
voluminous and time-consuming task but was interesting and warranted the effort given the large volume of rich data that was obtained in the subsequent analytical process. There were, however, limits to how much of this rich data could make its way into the final write-up due to the size constraints of the thesis. The most significant data is, however, reported in quotes from the interviewees. A great deal of other data collected has informed the overall analysis and interpretation presented herein.

The first question posed in each interview was open-ended and asked the interviewees to elaborate on any issues, problems and/or shortcomings associated with their hotel’s dealing with asset related expenditure practices. This proved to be a useful approach as many interviewees provided unprompted commentary. Data analysis was conducted by examining the transcribed interview data for common themes and latent variable relationships. This was achieved through the use of ‘NVivo 7.0’, which is widely-viewed as the most prominent qualitative data analysis program (Sorensen, 2008). Use of NVivo was beneficial because it saved on the time taken to sort transcribed interview data according to main topics and sub-headings (i.e. by coding through the use of nodes). It must be noted, however, that NVivo does not do ‘the thinking’ (Richards, 2004). A further advantage of NVivo was that it facilitated a strong electronic record keeping function for the information gathered, and also allowed for a robust analysis of relationships in the interview data.

Whilst attending the interviews, the researcher had the opportunity to seek other sources of evidence. Documents such as confidential hotel management contracts, financial statements and other materials were sighted and/or obtained by the researcher. Each interviewee was forwarded an executive summary of the interview findings as both a token of the researcher’s appreciation for their participation in the study and also to seek feedback and confirmation of the findings, a step recommended by Atkinson and Shaffir (1998). In arranging the interviews, a total of twenty-five potential interviewees were contacted. Interviewees were selected from contacts gathered from the endorsees of the study. This resulted in approaching potential interviewees of a high calibre with much knowledge and interest in the area. Initial contact was achieved via a mailout of an interview information package, which included a flyer (see appendix A) highlighting the study’s endorsement from three leading hotel consulting companies: Jones Lang LaSalle Hotels, Cushman and Wakefield Hospitality, and Horwath Hotel, Tourism, and Leisure. This flyer also gave an outline of the objectives of the study. The aim of this flyer was to stimulate interest in the study and to highlight the
professional nature of the work being undertaken. In addition to the flyer, a covering letter was also enclosed in the mailout envelope (see appendix B). This letter asked the potential interviewees for their participation in the interview process and informed them to expect a future phone call from the researcher to discuss the request. When making phone calls to the potential interviewees, deliberate steps were taken to ensure the potential interviewees felt no pressure to participate. This step was seen as going some way toward ensuring that participants would be interested and willing to be involved in the study, a strategy designed to enhance the richness of the data gathered. Jones (1985, p. 50), for example, comments that where interviewees are not interested in taking part, the interviewee will:

… seek to get the interview over as quickly as possible, with enough detail and enough feigned interest to satisfy the researcher that he or she is getting something of value but without saying anything that touches the core of what is actually believed and cared about in the research.

By adopting a conservative approach to the solicitation of interviewees, of the original twenty-five potential interviewees contacted, twenty agreed to participate. Of the five interviewees that did not wish to take part, three indicated that they were unable to participate due to lengthy overseas commitments and two indicated that they were facing difficulty with time constraints. For those interviewees that were willing to be interviewed, a convenient time for the interview was organised and a copy of the interview schedule was forwarded (Baxter & Chua, 1998). Each participant in the interview phase was promised confidentiality and his or her anonymity was assured. For this reason the names and details of each interviewee are not disclosed in this thesis.

Table 9.1 provides an overview of the sample of interviewees. The first column of the Table provides information pertaining to the organisation number, and the location of the organisation and hence where the interviews took place. From this column it is evident that interviews were conducted with more than one interviewee in some organisations. The second column provides the unique interviewee reference codes that will be used when citing a specific interviewee’s comments. The reference code ‘AM’ denotes an asset manager, ‘L’ denotes a lawyer, ‘AUD’ denotes an auditor, ‘O’ denotes an owner, ‘GM’ denotes a general manager, and ‘FC’ denotes a financial controller. The third column identifies each interviewees’ position within their organisation. An examination of this column highlights the high standing of the interviewees in their organisations. Many of the interviewees had more than twenty-five years experience in the hotel industry. The final column highlights important
characteristics associated with the interviewees’ role in their organisation and important organisation details.

<table>
<thead>
<tr>
<th>Organisation / hotel number &amp; location</th>
<th>Interviewee code</th>
<th>Position</th>
<th>Important characteristics of interviewee’s role in their organisation or hotel</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (Brisbane)</td>
<td>AM1</td>
<td>CEO</td>
<td>All representing large hotel consulting companies. Typically working as agents who are engaged as a third-party by the owner.</td>
</tr>
<tr>
<td>2 (Sydney)</td>
<td>AM2</td>
<td>Director</td>
<td>Working as an in-house asset manager employed directly by hotel owner.</td>
</tr>
<tr>
<td></td>
<td>AM3</td>
<td>Director</td>
<td>Considered by several other interviewees to be the two most prominent lawyers drafting hotel management contracts in Australia.</td>
</tr>
<tr>
<td>3 (Sydney)</td>
<td>AM4</td>
<td>Director</td>
<td>Experienced in conducting audits of large listed hotel owning companies.</td>
</tr>
<tr>
<td></td>
<td>AM5</td>
<td>Group executive</td>
<td>Representative of a large listed property trust owner.</td>
</tr>
<tr>
<td>4 (Brisbane)</td>
<td>AM6</td>
<td>Manager hotel operations</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>5 (Sydney)</td>
<td>L1</td>
<td>Partner</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>6 (Sydney)</td>
<td>L2</td>
<td>Principal</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>7 (Brisbane)</td>
<td>AUD1</td>
<td>Partner</td>
<td>5 star hotel, approximately 300 rooms, operated under a management contract by a large international management company. Strata titled ownership, one large developer owner owns the majority of strata.</td>
</tr>
<tr>
<td></td>
<td>AUD2</td>
<td>Partner</td>
<td>3.5 star hotel, approximately 400 rooms. Until 2006, was operated under a management contract by a large international management company. Owner was a high net worth individual. Hotel now owned by developer and run independently. General manager and financial controller remain the same under new ownership.</td>
</tr>
<tr>
<td>8 (Sydney)</td>
<td>O1</td>
<td>Tourism &amp; hotel portfolio manager</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>9 (Sydney)</td>
<td>O2</td>
<td>Executive</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>10 (Sydney)</td>
<td>O3</td>
<td>Senior fund manager</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>11 (Gold Coast)</td>
<td>GM1</td>
<td>General manager</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td></td>
<td>FC1</td>
<td>Financial controller</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>12 (Gold Coast)</td>
<td>GM2</td>
<td>General manager</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td></td>
<td>FC2</td>
<td>Financial controller</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>13 (Gold Coast)</td>
<td>GM3</td>
<td>General manager</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td>14 (Gold Coast)</td>
<td>GM4</td>
<td>General manager</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
<tr>
<td></td>
<td>FC3</td>
<td>Financial controller</td>
<td>Owner from a large unlisted property trust.</td>
</tr>
</tbody>
</table>

Note: room numbers have been rounded to the nearest “50” to protect interviewee anonymity.
Table 9.1 shows that the asset manager group comprised of both third-party and in-house asset managers. As a generalisation, it appears the distinguishing factor determining whether an asset manager is employed in house or as a third party agent for the owner concerns the size of the owner in terms of the number of hotels and rooms that they hold. For owners holding several hotels, it is, for example, economically efficient for them to employ their own in-house asset manager. A high degree of networking was also apparent amongst many of the interviewees, which enabled a deeper understanding of the dynamics at play within the Australian hotel industry. O3, for example, commented:

We all know each other (i.e. all the key players in the Australian hotel industry) and we often go and have a coffee together or have a few beers at the pub. There are not too many secrets and we have all worked somewhere else before with somebody else so I think that there is good information dissemination in the hotel industry in Australia.

One comment that was found to not easily fit in the structure of the following interview findings, but that was illuminating in terms of describing the perceived usefulness of a hotel owner’s engagement of the services of a hotel management company through a hotel management contract is noted here. GM2 commented:

Management companies (i.e. operators) take a lot out of it. I mean, they are really not here in the interests of the owner necessarily. They are looking at the bigger picture and are very self-interested. I mean, a lot of the national purchasing which is a big sell to the owner to get them to use a management company, it really is just a joke and it doesn't really do much. Believe me, the owners of properties that use management companies are really paying a premium and the money is going to head office basically. Management companies rip a hell of a lot of money out. All of the management companies' guest programs and loyalty programs and that sort of thing, okay, some hotels might get a little bit of benefit from that bit but I don't believe that it is as much benefit as the management companies make out.

These comments suggest that operators are well positioned to act opportunistically in order to divert resources toward their own benefit. A further important comment that was difficult to fit into the structure of the interview findings but adds further insight into the discussion of ‘in whose interests the general manager is likely to act (i.e. the owner’s or the operator’s)’ was made by GM1 in connection with his employment contract with the operator as follows:

I am a direct employee of the operator but I also have a dotted line to the owner that I am to act in their interests as well as the operator's interests … if I started to make decisions that were owner biased then I would have the operator on my back. If I started to make decisions that were operator biased then I would have the owners on my back, so I have to be very careful to be fair to both parties …. My employment contract is the only employment contract in the entire hotel that is actually written by the operator but I must be fair to both parties.
The comments of GM1 highlight the conflicting interests that general manager’s face in their day-to-day duties between acting in the owner’s interests versus the operator’s interests. These comments highlight the need for general managers to achieve a balanced approach in managing this conflict.

9.3 The interview schedule

A relatively flexible approach was adopted with regard to the development and delivery of the interview schedule (see appendix C). The interviews, for example, moved from an unstructured orientation to semi-structured questioning (Lang & Heiss, 1998). In the initial stages, interviewing was largely unstructured and open-ended questions were used in order to gain a broad understanding of general issues relating to asset related expenditure in Australian hotels. This approach also helped to open the topic up for discussion and to identify any significant issues that had not been thought of or uncovered during the literature search and conjecture components of the study. The inclusion of some open-ended questions in the interview schedule was also thought to assist in reducing the potential of bias from the researcher imposing opinions, attitudes or answers onto the interviewees (Easterby-Smith, et al., 2002). The interview schedule, however, also included a series of semi-structured questions that probed for more specific issues. The interview schedule was modified based on feedback to the questions posed and the judgment of the researcher as the interviews progressed (A. Atkinson & Shaffir, 1998).

The course of the typical interview involved, firstly, informing the interviewee of the focus of the study. The interviewee was invited to talk in general terms about issues arising with regard to the conduct of the study. During this stage it was common for the interviewee to raise issues identified for discussion later in the interview schedule. This approach yielded many useful insights that were not anticipated in the early stages of interviewing. The researcher used judgement throughout the interview process concerning the extent to which the interview schedule was referred to.
9.4 Investigating the locus of power between hotel owners and operators (research objective one)

In recent years there appears to have been an increasing diversity of clauses negotiated into hotel management contracts, which are influenced to a great extent by the locus of power between hotel owners and operators. Prior to the early 1990s, for example, the locus of power in Australia was heavily in favour of the operators. Interviewee AM1, for example, commented:

The locus of power between the owners and operators in the 1990s was operators 99% and owners 1%.

An economic collapse in the 1990s, however, signified a movement in the power balance away from operators as the supply of new hotels dried up. If operators wanted to continue their growth, they had to be much more competitive in attracting hotel owners. This move in the locus of power towards owners continued until around 2001, at which time the balance was tipped heavily in favour of owners. AM1, for example, commented:

Somewhere around 2001 the locus of power went right the other way where owners had a lot of power and operators had very little power. It was operators 1% and owners 99%.

Since 2001, however, the locus of power in Australia has been moving back towards operators and is currently approximately 60% owner and 40% operator. Much of the reason for the shift is that operators have consolidated into larger and therefore more powerful groups. In addition, operators typically do not contribute any capital to the operation of a hotel and therefore their capital risk is lower than that of owners. Interestingly, although there is a reluctance among operators to put forward capital, largely as a result of their shift toward becoming pure hotel operating companies, some hotel owners have found ways to make operators contribute towards capital projects in their hotels. O3, for example, commented:

The operators don’t want to put capital in any more …. to make them pay toward capital projects that they might really want, I get them to stand aside from their management fees for a while …. Another way to do it is to get them to expense the asset cost (rather than capitalise it) so that they have to take a hit on their incentive fee (which is typically linked to GOP).

The shift in the power balance relative to the 1990s has also resulted in a reduction in the typical length of management contracts, which now tend to be negotiated for periods between five and ten years rather than thirty years. Indeed, some contracts are now as short as three
years, with performance based termination notice periods of only nine months. Relative to the 1990s, owner satisfaction has also now taken top priority for hotel operators. GM3, for example, commented:

In the old days, the entire focus (of the operator) was on customer satisfaction. Nowadays, number one is owner satisfaction, number two is fulfilling the owner’s requirements, and number three is customer’s satisfaction.

The interviews further found that the locus of power between owners and operators is constantly changing and various factors can affect it. For example, the larger the owner or the operator, the more power they will wield. O2, for example, commented:

Where you have a large owner and a relatively small operator, you might see the locus of power going even higher to something like owner 70% and operator 30%. On the other hand, where the owner is small and the operator is large, you might see the power coming back a bit to something like owner 50% and operator 50%.

A further pertinent comment on the same issue was made by L2, who commented:

I tend to say, if you look at a continuum and you have 0 to 10, 0 is totally owner dominated and 10 is totally operator dominated. Most of the smaller operators are probably around about 3.5 but the larger internationally recognised operators are like eighty tonne guerrillas, you know the Rydges and Hyatts and these guys, so they are probably more like 6 or 7 … and it works the other way as well for the owners … The giants of hotel ownership like the Thakrals etc. are big guerrillas as well and so they would probably be about a 3 or 3.5 … it (i.e. the determination of the locus of power) basically gets down to the respective size of the owner and operator and how these sizes interact.

A further factor influencing the owner / operator locus of power relates to whether the hotel is located in a Central Business District (CBD) location. Hotels located in a CBD location typically give the owner a strong locus of power relative to the operator. AM5, for example, commented:

If the contract is negotiated in a location where a specific brand of an operator doesn’t have a presence, and needs a presence to serve their customers globally, these types of operators will go to any lengths and agree to any terms and conditions and will do whatever the owners want to get this location.

Owners of hotels in CBD locations also hold a strong locus of power due to the limited supply of new hotels coming onto the market, high consumer demand for hotel services, and the hotel operators’ desire to have a brand presence in these locations to complete their portfolio offering. On the other hand, hotels located outside CBD locations tend to be in markets that have more new supply and less competition among operators, so operators in
such locations tend to find their power balance increasing relative to owners. O3, for example, commented:

If you have a four-star, or a five-star hotel in CBD Sydney, Brisbane or Melbourne, the operators will be fighting over it, but if you told me that you have this really great property in Port Macquarie, you know, Port Macquarie is in a nice area but it won't hold the same weight and the operators won't be fighting for it as much, so the locus of power depends to a large extent on where the hotel is located.

A further factor that can affect the owner / operator power balance is the strength of an operator’s brand. If owners wish to secure a high quality brand with good global presence, they must often compromise during negotiations with strongly branded operators. In addition, when the owner has an operator’s brand in more than one of their hotels, this can enhance the owner’s power. AM6, for example, commented:

We (i.e. the owner) own two out of five (hotel name withheld) hotels in Australia so that gives us a pretty good influence and leverage over (the operator).

The composition of the management team of an operator can also influence the locus of power. Generally, more qualified and experienced general managers and financial controllers provide more power for the operator. Operators also typically prefer large hotels in good condition because these types of hotels can deliver higher fees and better economies of scale than smaller hotels in poor condition. Therefore, owners of large hotels in good condition typically have a strong locus of power. A final factor influencing the power balance is the credibility and reputation of owner and operator. Generally, the stronger the reputation and track record of either party, the stronger that party’s locus of power relative to the other party.

9.5 Approaches to FF&E reserve accounting (research objective two)³

Within Australia, it appears that currently around 50% of management contracts have cash FF&E reserves, 45% have notional (i.e. non-cash) FF&E reserves and that 5% or less have no FF&E reserve. The choice between these approaches is typically governed by the relative locus of power between the owner and operator. For example, owners with a strong locus of power relative to the operator are likely to succeed in adopting notional or no reserves,

³ In the U.S. there is confusion between what is meant by ‘FF&E reserve’ and ‘replacement reserve’ (see Mellen, et al., 2000). The terms, however, are used interchangeably and mean the same thing. AM1, for example, commented: “It can be called the FF&E reserve or replacement reserve or capital replacement reserve. There are different titles to explain the same thing.”
whereas, owners with a weak locus of power relative to the operator are likely to adopt cash reserves.

Operators typically prefer cash FF&E reserves because it reduces the likelihood of the owner having insufficient funds available for required FF&E expenditures, which can be damaging to an operator’s brand standard. Owners, however, dislike cash FF&E reserves because they view the setting aside of their money into a physical bank account, which typically accumulates a relatively low bank deposit return, as a poor investment and a burden on their cash flow. Owners prefer to have control of their cash and for this reason they see a notional or no FF&E reserve as preferred options. These conflicting objectives highlight a further area in which owners and operators have differing objectives and where differential risk aversions may be manifested. The comments of AM2 encapsulate the essence of the argument:

The operator’s want to see a physically cash funded FF&E reserve account so that they know when spending is needed, the owner doesn’t say ‘well we haven’t had a good year so we’ll delay the spending for two years’. This is because the operator is worried that the brand standard will slip if the hotel deteriorates below these standards and also, the operator could argue that the room rates could slip if, for example, he can’t deliver a five-star product if it’s a five-star hotel. These days the owners say, ‘well hang on a second, if I’ve got to put cash each year into a reserve, that just sits there for six years before we need it, that’s stupid! That’s a complete waste of our cash flow resources! So I’ll tell you what, we’re a big owner and we’ve got assets worth $8 billion so we’re pretty good for the cash so you guys go ahead, we’ll do notional accounting for the FF&E reserve contribution but when we get to year six we’ll write the cheque’. See this is the old question about other peoples’ money. If the operator has a reserve fund sitting there with $5 million in it at any one time, they’re always going to find ways to spend it because they’re not spending their money, they’re spending the owner’s money. On the other hand, if the operator has to go and knock on the door of the owner and ask for a million bucks to spend on something, the owner says ‘I’m in control, I’ll tell you whether I want to give it to you, don’t tell me, I’ll tell you whether we’re going to spend the money, alright’. It all comes down to the balance of power between the owner and operator, and only strong owners will succeed in getting notional FF&E reserves.

There appear to be two different approaches to cash funded FF&E reserves. The first method involves the owner maintaining a separate FF&E reserve bank account and contributions to the reserve are made automatically at either monthly or quarterly intervals. If the owner fails to generate sufficient funds in a month or quarter to finance the instalment, the owner must top up the reserve to an equal amount from their private funds. An example of the terms of such an arrangement were found in a management contract produced by AM4:
The operator is entitled to pay from the operating account the required amount into the FF&E reserve or, if necessary, the owner must pay an amount equal to this contribution for each month.

Under this approach, the operator is typically the sole signatory of the bank account and has full control over the spending of accumulated reserve balances. For example, according to the same management contract provided by AM4, the terms read:

The operator may make any expenditure that they wish to make from the funds available in the FF&E reserve.

This method of cash FF&E reserve accounting was widely adopted in older management contracts because prior to the early 1990s, operators held the locus of power relative to owners. There are many instances of these arrangements still in operation as many older management contracts were entered into for up to thirty years or more.

The second cash FF&E reserve accounting method has similar funding arrangements, however, the owner has control over drawing down the account. This alternative method therefore represents a tightening of control over the release of funds from the reserve by the owner and may help to restrain an operator’s ability to act opportunistically with regard to how FF&E reserve funds are expended. Most recently established management contracts that feature a cash funded FF&E reserve adopt this alternative approach.

Under notional FF&E reserve accounting arrangements, there is no physical cash fund, instead the owner simply provides for FF&E expenditure in accounting records. This approach was first applied in Australia in the early 1990s, when owners began to gain a stronger locus of power relative to operators as many hotels fell into receivership and owners had insufficient cash flow to fund the reserve. It also appears that very few Australian operators are willing to commit to ‘no FF&E reserve’ contracts. Where such contracts are negotiated, however, it is usually as a result of the owner having an exceptionally strong locus of power relative to the operator and the operator having considerable trust that the owner will spend the required amount on FF&E. L2 commented:

If there is no FF&E reserve it will usually be the case through the driving of a ruthless owner who pretty much tells the operator to get stuffed, but the owner in these situations is usually an owner that has a demonstrated ability to look after a hotel. The

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4 In some situations, the owner allows the operator to retain sole signatory rights up to a certain dollar threshold, above which, the owner must co-sign cheques.
FF&E reserve is nothing more than a security policy for operator protection and if you are comfortable that the owner will protect your brand by spending the money, then the operator might be comfortable to go with a nil FF&E reserve.

Despite the perceived benefit to some owners of the ‘no FF&E reserve’ approach, many owners see the FF&E reserve as providing an important funding discipline. O1, for example, commented:

If you don't spend any money on FF&E, it would be like shooting yourself in the foot. I don’t like the idea of no reserve.

AM4 also mentioned that running a hotel without an FF&E reserve would be like “digging your own grave”. Overall, interviewees appeared to concur that operating with some form of FF&E reserve, whether it be cash or notional, represents good hotel management practice.

Where a cash or notional FF&E reserve approach is adopted, it was found that it can be established according to an individual or portfolio arrangement. The individual arrangement applies in situations where a hotel owner owns an individual hotel, which is operated under a distinct hotel management contract. Larger hotel owners who own a portfolio of hotels with a similar star-rating and are operated by the same operating company are more inclined to use a portfolio reserve arrangement. Under this approach, a pooling arrangement applies whereby reserve monies from each individual hotel accumulate in a portfolio FF&E reserve account. From this portfolio FF&E reserve account, individual hotels then draw down on the reserve in accordance with their annual budgets. If each hotel allocates three per cent of their gross revenues annually to the portfolio FF&E reserve, it would be possible for some hotels in the portfolio to spend greater than, and others less than, three per cent in any one year. Over a five year period, however, the management contract typically stipulates that each individual hotel in the portfolio shall not exceed an average spend on FF&E of three per cent of gross revenue. Such an arrangement is thought to enable more efficient use of an owner’s money.

9.6 Owner and operator attitudes with respect to the sufficiency of funds allocated to the FF&E reserve account (research objective three)

It appears that the majority of Australian hotel management contracts provide for an increasing scale of FF&E reserve contributions during the first three to five years of a hotel’s operations. This then levels out to around three per cent of gross revenue annually. Higher
reserve allocations of up five percent of annual gross revenue are sometimes made for resort hotels, where location specific factors, such as salt in the air for a beachside hotel, can contribute to higher levels of wear and tear than more conventional hotels.

Interviewees felt that FF&E reserves are grossly under-funded in Australia and that they are only intended to go part of the way toward covering the true cost of FF&E replacement. A more accurate allocation to cover all necessary FF&E expenditure after the first three to five years of a hotels’ operation was said to be closer to five per cent of gross revenue and in resort hotels the figure would be closer to seven percent. A potential reason for the under-funding is that the formula used to allocate funding to the FF&E reserve is flawed. AM2 commented:

Whoever came up with this percentage of gross revenue method in the first place was an idiot because what has spending on FF&E got to do with gross revenue anyway? There is no natural correlation at all. I think these days it would generally be accepted that three per cent of gross revenue is not adequate, but I think a lot of owners would say ‘well to the extent that that it is not adequate, that's fine, because we will deal with that when we get to it.’ So the fund in that context is not really meant to be an exhaustive accounting for the future FF&E contributions, it's meant to be a significant way towards it, but there may well be a need for a top up directly from the owner’s private funds.

L1 also saw the method of using a percentage of gross revenue to allocate funds to the FF&E reserve to be flawed. He commented:

A problem that you have in a place like Australia is that the room rates that we can charge are so abysmally low in comparison to other countries in the world. If that (name withheld) hotel in Sydney were transplanted to London, you would get $1,500 a night rather than $250 a night. If it were in Tokyo, you would get the same, exactly the same hotel! Your percentage of gross revenue would be lower because the amount of dollars that you need to maintain the hotel is still the same and has no relationship with the room rate of the hotel. In fact, the whole thing gets even worse because they actually spend a lot less to keep a hotel at a set standard in a place like London compared to Sydney!

These comments suggest that the percentage allocation needs to be calibrated to country and regional variables. This can present a management challenge for international management companies, however. L1 further commented:

A potential reason for the fixation on three per cent could be that most of the hotel industry is driven by international hotel companies. They’re global companies and what happens, and it sort of emanates from a time when hotel owners were largely unsophisticated, so what you’re trying to establish is international uniformity because if everybody got wind of the fact that in London the FF&E reserve is one per cent, yet
in Sydney they are asking for five per cent, intuitively the guy in Sydney will think that he's getting ripped off.

O1 added further illumination of these issues by commenting:

I think derivation of the three per cent figure came from hotel operators, and it is American and it has been around for a long long time, for as long as I can remember and I think that it has just been a sort of thing that has become almost like the gospel, but I think that operators have always known that it is more than three per cent, but in the negotiation of contracts they don't want to disillusion or create concern with the owners, so they play it down, but they know full well that with only three per cent they will have to go to the owner and ask for more money and if the owners want to take it from the FF&E reserve, chances are that the operator would say that the FF&E reserve has already been fully spent, so there is no other option but to ask the owner for the money. I mean, the operators don't want to create a reputation that hotels require a lot more FF&E spending above three per cent of gross revenues. I think some of it also happens when you start with a new hotel. Because with the new hotel you can probably get away without spending much on FF&E for a few years because everything is new. For example, in the first few years of the hotel's life you might be able to get away with a one per cent or a one and a half per cent FF&E reserve and then obviously after three or four years it is going to hit you when everything starts to wear out and needs replacing.

These comments suggest that international operating companies generally understand and know that hotel FF&E reserve requirements are typically greater than three per cent of gross revenue in some parts of the world, but that it can be beneficial for them to apply a universal approach so as to not disillusion or create concern amongst owners.

The systematic underfunding of FF&E reserves could also be due to owners’ risk aversity, i.e. seeking to maintain control over funds and also FF&E spending in order to limit the influence exerted by operators over how their money is spent. Therefore, owners intentionally set FF&E reserve allocations low, so that if they require additional funding over and above what is in the FF&E reserve, the owner has full control in this decision. Indeed, in such situations, to secure additional funding, the operator has to demonstrate that a higher level of expenditure is required. AM1 captured the essence of this claim as follows:

Experienced owners know that three per cent will never be enough. If the true level is, say, six per cent, will an owner accept six per cent? Absolutely not! Because that gives control, or at least influence at the very least, to the operator who has no capital invested, and the owner will want to make those decisions themselves and not have them made for them by the operator.
AM1’s comments also seem to suggest that owners adopting such an approach may be able reduce the scope for operators acting opportunistically with regard to how reserve funds are spent. L1 further commented:

I have heard a number of operators say that it really should be six per cent but I have never seen an operator being able to convince an owner to agree to an FF&E reserve number of six per cent! It's a lot of money, six per cent of revenue.

A further reason for the continued under-funding of FF&E reserves is that although experienced owners understand that allocations of three per cent to the FF&E reserve will only represent a partial contribution towards FF&E spending, new buyers, particularly from overseas, can sometimes enter the hotel industry without an appreciation that more than three per cent is required. AM1, for example, commented:

I think if some new owners knew how much has to be spent, they’d be frightened and I don’t think you’d ever get another person investing in hotels again!

It also appears that although some hotel owners understand that three per cent is insufficient, they will persist with it, or attempt to reduce it as far as possible, due to their belief that it is saving them money. What these owners fail to realise, however, is that if FF&E spending is insufficient, despite short-term savings, it can adversely impact on the long-term profitability of their hotel. AM5 commented:

I think that it is a very dangerous thought if owners think that only three per cent of gross revenue is required for future FF&E, because in reality the owner will have to spend much more than three per cent. I think that FF&E should be understood to be a fund of money that should “support” spending on FF&E, but will not be fully sufficient for all FF&E spending … If FF&E spending is insufficient, it can severely damage a hotel’s quality, credibility and reputation in the market.

GM3 believed that there are owners with a mentality of spending very little on FF&E, but their numbers are declining. He commented:

If you think short-term, then you end up out on the street …. but we had one case where some potential owners came in to have a look and they were saying things with a view to sort of, ‘we can replace that marble with tiles, we can paint over that wallpaper, there are three towels in each room so we won't be buying any new towels for a while, we will just take one out now and keep that as backup stock to save money. We will also sell our linen press because we won't iron the sheets, we will just put them straight back on the bed, we don't have the money for that. The people cleaning the room, instead of giving them 32 minutes per room we’ll give them 18 minutes. We can sack half the staff.’ Owners of this mentality don’t want to spend much and don’t usually release funds from the FF&E reserve easily and it ultimately makes the product crap. I mean, in three years your product will be worth absolutely nothing and it will take five years to build the business back up, but there are owners
who think like that, but thankfully more owners are now realising that you have to put
the money in because it pays dividends.

AM4, however, suggested that there are still many hotel owners who think that three per cent
of gross revenues will be sufficient for all required FF&E spending, mainly due to their
general lack of hotel knowledge:

If I make an overall umbrella statement saying that the hospitality industry in
Australia is fairly amateuristic! Most owners in the industry are reactive rather than
proactive. You don't want to know how many hotels are out there that don't have an
adequate FF&E reserve fund and they have absolutely no idea what is potentially
hanging over their heads.

AM4’s comments appear to indicate that due to some hotel owners’ deficient knowledge of
hotel operations, operators may have some scope to act opportunistically or evade effort. A
further reason for the use of three per cent, however, is that it can assist hotel owners to
secure funding from banks. L2 commented:

If a higher number were used, the industry would suffer in terms of getting sources of
finance to buy hotels, because the banks usually factor the three per cent figure into
their calculations.

The fixation on the use of the three per cent figure could also be because it can be convenient
for hotel owners when preparing for a sale. When hotels are to be sold, future FF&E
requirements are typically incorporated into the valuation of the property at the rate at which
FF&E reserve contributions are made. If this amount were raised, it could have a damaging
effect on the appraised value of a hotel. O1 commented:

My personal view is that valuers usually undervalue future FF&E requirements on
hotels …. If a valuer uses four per cent instead of three per cent on a $500 million
property, that is a big difference on the valuation.

A final reason for the continuing use of three per cent, is that the number is often used as a
bargaining chip in the negotiation of a management contract. GM1 commented:

Many operators allow the owner to set the level of FF&E reserve low because unless
they do this, they won’t be able to get the management contract in the first place. You
have to win the business.

Overall, the view of the interviewees was that, although grossly underfunded, there is not
likely to be any change in the universal rule of thumb of allocating three per cent of gross
revenues to the FF&E reserve in the near future.
9.7 Problems surrounding the release of funds from the FF&E reserve account (research objective four)

The majority of management contracts (particularly in four and five star hotels) create a legal obligation on the owner to release funds from the FF&E reserve to enable the operator to undertake budgeted FF&E projects. This obligation arises from the use of a brand standard clause, which is designed to prevent an owner refusing to pay FF&E to the point where hotel deterioration results in a substantial loss in profitability. Assessment of whether a hotel meets the brand standard is typically achieved via a quality audit. If hotel fails to pass a quality audit, and if rectification work to bring the hotel up to the brand standard is not undertaken, then the operator can terminate the management contract.

Owner resistance to releasing funds from the FF&E reserve often stems from cash flow difficulties, although sometimes, ill informed owners simply refuse to spend the money as part of a cost saving measure. The damage of an owner failing to expend an appropriate level on FF&E is captured by comments made by FC2:

The owners of this hotel were very reluctant to spend funds in the FF&E reserve … the place was just shocking … Eventually the owner spent the money, but it took a great deal of time and effort on our behalf to rebuild our relationship with the customers and to rebuild the credibility in the marketplace.

A fundamental challenge confronted by operators in enforcing their contractual right to a release of funding from the FF&E reserve concerns the fact that there is generally no recourse for them, other than to terminate the contract, if the owner fails to release funds in the FF&E reserve. L2, for example, commented:

There is a definite contractual obligation on the owner to release funds from the FF&E reserve, but so what anyway. I mean, if the owner doesn't spend the money, what does the operator do? Do they walk away? The whole difficulty here is that the operator does not have any recourse whatsoever. At the end of the day, all they can do is ultimately take their flag down, but why would they do that if they are making a million dollars a year from each property? Okay, the hotel might not be doing great things from your brand standard point of view, but if it's making money. The operator basically has no leverage if the owner doesn't pay, regardless of what the management contract says.

The comments of L2 suggest that operators will seldom terminate a management contract on the grounds of the owner failing to release FF&E reserve monies, due to the potential financial losses resulting from management fee income foregone. Seeking a contract
termination can also tarnish the reputation of an operator, as future owners may not wish to deal with an operator that has terminated a contract on such grounds. It should also be recognised that information dissemination in the Australian hotel industry is very strong due to the small number of key players involved. AM5 commented:

The hotel market in Australia is so small and the owners and operators know each other, so if an operator does something that an owner doesn’t like, then everyone will find out and it’s not so good for their reputation and they will inevitably lose business.

Due to the downside associated with terminating a management contract, operators usually prefer to allow an owner to replenish and redeem their FF&E reserve funding at a later point in time. AM2 encapsulated the essence of the argument as follows:

Down at the real world on the subject, it comes down to cash flow. If there isn't enough cash flow, if cash is very tight, the owner will say to the operator ‘look I don't really care what is in the management contract or what you think, I mean, I might agree with you if we had more cash but I haven't so it's (i.e. the budgeted FF&E expenditure) going to have to be pushed back one year and we will review it in twelve months time’.

An unwanted side-effect to hotel owners of the increased use of the brand standard clause has been that many owners now concentrate their FF&E reserve spending on projects that uphold the brand standard, which may sometimes not reflect an owner’s preferred spending approach. This goal conflict has led to some owners arranging FF&E spending so that the brand standard is only minimally maintained, allowing them to leverage as much as possible on the brand. The degree to which owners can do this, however, is limited by the fact that it is the operator that is charged with the preparation of the annual budget as well as a forecast for the next five years’ FF&E spending. The five-year FF&E forecast, however, is usually not given to the owner, but is used as an internal planning document by the operator. The annual budget is given to the owner. Consistent with conventional budget preparation, for a hotel’s FF&E component of the annual budget, all heads of departments submit requisitions for proposed FF&E projects. Conventionally, the next step is for the owner, operator, asset manager (if there is one), general manager and financial controller to review the department heads’ proposals and eliminate low priority projects as part of an FF&E rationalisation exercise. It was noted that high priority projects are often driven by the meeting of brand standards as well as by customer complaints. Where an operator prepares the annual budget, and also has a brand standard clause, there appears to be a heightened potential for the operator acting opportunistically with regard to how an owner’s resources are spent.
Upon finalisation of the budget, the owner typically commits to fund all budgeted projects from the FF&E reserve. If the owner refuses to fund a planned expenditure in the budget from the FF&E reserve, the operator is in a legal position to defy this decision by taking the money required out of the hotel’s cash flow. Operators, however, are generally reluctant to take such a step, for fear of creating a highly adversarial relationship. Once the budget is finalised, it is common for only about one-third of the projects originally put forward to be supported in the annual budget for the forthcoming year.

Where there are small changes to budgeted projects, this generally provides the owner with the right to refuse to fund the project from the FF&E reserve until such time as another capital budgeting proposal for the project is completed, submitted, and agreed to by the owner. In other situations, the owner might allow the project to proceed, but ask for detailed explanations of any variances from the budgeted figures.

Where new projects arise during a year that have not been budgeted for, but warrant urgent attention, hotel owners typically require a capital budgeting proposal to be prepared by the operator. If approved, owners will often ask the operator to drop some other planned expenditure from the approved budget. If there are insufficient funds in the FF&E reserve to fund a new project, and if owners consider the project necessary, they can fund the difference from their own funds to avoid hindering a hotel’s performance. It was noted that in some cases, an arrangement can be struck whereby the owner agrees to fund an FF&E reserve shortfall, but the operator has to commit to rectifying the shortfall from the subsequent year’s FF&E reserve allocation. Another approach that can be taken when confronting an FF&E reserve shortfall is again for the owner to fund the shortfall, but for the operator to waive their management fees for a certain period of time. In this way the operator is effectively funding part of the expenditure. Another variation is that the operator can be asked by the owner to expense the FF&E expenditure (i.e. as repair and maintenance expense), which will mean that the operator will bear a reduction in their incentive management fee for the year, as these are typically tied to GOP.

There was also speculation that many owners like to see the systematic charging of CapEx projects (i.e. non-FF&E capital costs that should not be funded from the FF&E reserve but by the owner’s private funds) to the FF&E reserve so that the reserve becomes quickly exhausted. The adoption of such an approach is said to give the owner greater control over
how their money is spent. The propensity for such owner behaviour is also heightened where an owner is nearing the end of their investment time horizon (i.e. when they are about to sell).

When owners take this approach, however, operators appear to counter it by using monies in the repairs and maintenance budget to fund FF&E projects. L2, for example, commented:

If you ever see the repairs and maintenance budget go above four per cent of gross revenue in a year, you know that basically the hotel is in trouble because the owner is likely putting CapEx through as an FF&E capital cost and the operator can’t survive like that, so they start expensing FF&E costs as repairs and maintenance expense…. You can do this by playing with the definitions (of accounting standards) to suit your needs.

GM1 supported this view by commenting:

Another way to get money out of the owners is to charge things to the repairs and maintenance budget and we do this quite often.

Another variation in budgetary behaviour occurs when an operator attempts to protect their FF&E reserve by getting the owner to fund projects that should be classified as FF&E, as an owner’s CapEx.

9.8 Investigating the relative importance of quantitative investment appraisal in hotels (research objective six)

The mix of quantitative and qualitative capital budgeting appraisal techniques applied to capital budgeting proposals appears to be related to the size of a capital budgeting project. For example, capital budgeting projects under $10,000 are typically regarded as small and projects over $100,000 as large. Small projects are evaluated mainly by qualitative capital budgeting appraisal techniques, but as the value of the investment increases, greater reliance is placed on quantitative capital budgeting appraisal techniques. O3 commented:

If they (operators) are coming to you (the owner) to buy ten new vacuums, well in that situation I couldn't care less and they can do whatever they want. The vacuums are $200 each, fine, big deal I would tell them to just go and buy them, but if you said to me that you want to spend $1 million to put in a new bar though, I would definitely want to see lots of numbers.

5 Common quantitative capital budgeting appraisal techniques applied by the interviewees include NPV, IRR, ROI, and Payback. Other numerical analyses such as sensitivity analysis, trend analysis, marketing mix analysis, competition analysis, forecasts and ratio analysis were found to be commonly used as part of a portfolio of capital budgeting appraisal techniques. Examples of qualitative techniques were said by the interviewees to include gut feel, intuition, instinct, experience and knowledge.

6 Examples of common large projects can include the addition of a new restaurant, conversion of space, addition of new rooms or a new spa facility.
Also, in connection with a small project, O2 commented:

We recently got a payback of over three years (which is outside their acceptance criteria) on a small project worth about $10,000, but we decided to go ahead with it anyway because we felt it was a good idea.

Regardless of the size of a capital budgeting project, it appears that there is always some mix of quantitative and qualitative capital budgeting appraisal techniques drawn on in the decision-making process. O3 commented:

I always use my experience in what I call the “sniff test”. After you have got the numbers, ‘does it smell good, or does it smell like crap?’ and that is where I guess that you use your gut feel and your instinct comes into play as to whether or not the project is good. I mean, does the project fall within things that you have seen before? Is it reasonable? You know, if the bar is turning over $20,000 of profit now and if you spent $1,000,000 on it, why would it suddenly start turning over $500,000 of profit?

On the same issue, GM1 commented about instances where large projects with poor ROI’s can still be accepted so as to avoid any loss in current performance. He commented:

Probably in most of the projects that we are doing now, if you actually put an ROI together, they would probably suggest that you don’t do the project, but I know to keep products up to standard we simply need to do them.

Supporting this perspective, O2 commented:

We get the operator to put forward all of the numbers and analysis and so on, and they will also send us a two-page summary of all of the theory behind why it is a good thing to do, and the effect that it will have. But sometimes we just do something because we want it to do it.

These interviewee comments suggest that no matter how large the project, there is always some element of qualitative capital budgeting decision-making. Indeed, it was further found that most hotel investments are not subjected to rigorous quantitative capital budgeting justification. AM3, for example, commented:

If you gave the owners a spectrum to choose from, from ‘ROI’ down to ‘simply need to do to maintain competitiveness’, for most investment projects, I reckon they’ll all tick the last box (i.e. they will tick ‘simply need to do to maintain competitiveness’).

A potential reason for owners using qualitative capital budgeting appraisal techniques in their decision-making is that some hotel owners consider inputs to the quantitative techniques too difficult to estimate correctly. O1, for example, commented:
Calculation of ROI is quite difficult. You can do it to justify your decision, but a lot of the time, if you back test, you are either too high or too low, or you just can't measure it at all. So I think that a lot of it is about experience. I mean, sometimes we find that if we do not get the right economic answer, but if we feel that it is the right thing to do, we will still go ahead with the project.

A further factor that appears to influence the extent of quantitative versus qualitative analysis of capital budgeting proposals is the type of hotel owner. Interviewees explained that different types of hotel owner are organised either publicly (i.e. public companies) or privately. Hotel owners that are public were found to make greater use of quantitative capital budgeting appraisal techniques than private hotel owners. It appears that the reason for this is that public hotel owners typically have a large total number of shareholders, of which a high proportion are institutional. These institutional shareholders were said to want the application of quantitative investment appraisal techniques as these were seen as being more objective and justifiable. L1 commented:

The more you move up the scale from a private individual to a listed public company, the more you are managing other peoples’ money and the shareholders typically have a much higher return requirement, which will effectively drive the hotel owner to achieve the results that the shareholders are seeking, so they need to be much more focused on the numbers.

A further illuminating comment about how different types of hotel owner can make varying use of quantitative, as compared to qualitative, capital budgeting appraisal techniques was made by L2, who commented:

I think that you could differentiate a hotel owner that is publicly listed as someone that is financially oriented as compared to a hotel owner that is a private individual that is emotionally oriented. It is to do with the psychological mentality of hotel ownership regarding whether they want to make money out of it (i.e. the hotel) … Traditionally what happened in the hotel industry is that hotels were owned by individual people and what these people basically did was bought a hotel just to showcase that they own a hotel (i.e. trophy hunter owners) so as to impress their friends and this would have been experienced in this country and overseas. The reason for this is that hotels typically have very unpredictable income streams, so essentially these people made the purchase of a hotel a vanity purchase and they were not too concerned about whether the hotel made any money. So their investment decisions were more about ego … That changed about five to eight years ago when ownership of hotels became more public and not driven by ego, but rather driven by financials on the bottom-line … The public owners have to be far more demanding with regard to having control over the property operationally and are far more vigorous with regard to budgets, and are far more disciplined and responsible to make sure that the hotel.

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7 Interviewees saw institutional shareholders as including investment banks, insurance companies, or superannuation funds.
performs financially well because their expectations are basically gauged by the marketplace, which is much different to the private ego owner. For example, the ego owner, if the hotel doesn’t make money it doesn't matter, but if it does, then that's just a bonus.

The above comments appear to suggest that where the hotel owner is a public organisation, operators will have less scope to act opportunistically as there will be greater monitoring from the owner. O3 further commented on the issue as follows:

As the owner gets more public, you're going to get more and more structured investment. You know, if I am going to go and buy something and you are a private owner, well then you just go and do it, but the public hotel owners have to have projects that meet ROIs and make sense financially.

The comments above also illustrate the way in which different types of hotel owner can be expected to vary their use of quantitative versus qualitative capital budgeting appraisal techniques. Supporting this view, O3, who acts on behalf of a listed public general property trust, commented:

My unit holders are constantly asking the question as to whether they can invest their money better elsewhere. Therefore, I have to provide returns that are as good as, or even better than what they expect elsewhere, and the unit holders will take a current view, as well as a future view, as to the current levels of capital spending and these are important in their decision of whether to buy, hold or sell.

AM6, who works on behalf of another publicly listed general property trust hotel owner commented:

Everything that we do is mainly quantitative …. If there is some logical reason that something needs to be done, then we will do it…. but it is generally based on the numbers.

On the other hand, AM2, who typically represents high net worth private individuals and trophy hunters commented:

High net worth individuals and the trophy hunters may want the lobby painted in gold, even more than the operator does, because they see the hotel as an extension of their own ego …. They have imparted their own judgements and views and tastes into the place, so they don’t usually make rational decisions.

AM4, also typically acting on behalf of high net worth individuals and trophy hunters commented:

At the end of the day, I don't look at hard numbers. I look at the case that they (operator) present and see if it makes sense …. To some extent it's just logic, it's a gut feel call decision.
These comments suggest that private hotel owners have a greater tendency to attach importance to qualitative factors in investment appraisal, as many of their investment decisions are driven by ego as they impart their own judgements, views and tastes into their hotel. On the other hand, public hotel owners seek greater use of quantitative investment appraisal techniques as they are seen as being more objective and verifiable than qualitative techniques.

9.9 Investigating the propensity of hotel management to positively bias capital budgeting proposals (research objective seven)

Potential biasing of capital budgeting proposals by operators appears to be a source of varying concern among different hotel owners. Operators are typically inclined to positively bias capital budgeting proposals toward projects that protect their brand, give their customers a consistent experience and raise their management fees. Owners, on the other hand, prefer the achievement of bottom-line profitability, which may not be promoted by operators positively biasing capital budgeting proposals. This set of circumstances underlines the conflict between the goals and objectives of owners and operators. The essence of this issue is captured in the following comment of AM2:

If the operator looks at capital spending and says that they need to do a refurbishment of the lobby because it needs to look prettier for half a million dollars, the owner often says, ‘forget the lobby, we have to replace the chillers because that’s more fundamental’. It’s not that the operator will deliberately not replace the chillers if they need to be replaced, but the operator tends to be always focused and biased toward promoting projects that will enhance the hotel’s image, perception and customer satisfaction because this all helps them make more money (i.e. through higher management fees) and protects their brand.

L1 commented on the same issue in the following manner, suggesting that operating companies, although faced with an opportunity to act opportunistically, may engage in such behaviour to differing degrees, in line with their established management philosophy:

There is always this demand, this hunger for the operator to basically spend money on the hotel and the owners are saying, ‘hang on, I have to face my shareholders and my investors and basically demonstrate that the profitability that they are getting from this hotel is as good as, or even better than, what we could have done had we invested in a commercial building or an industrial building or some other form of property’. I mean, operators are inclined to spend capital in order to maintain a brand standard. Owners, however, are only really interested in profitability so their hot buttons can be fundamentally different to an operator's hot buttons, so you do see conflict between
operators who wish to pursue capital spending in order to maintain a brand standard and owners who try to maximise profitability. But it's a function of the flexibility of the operating company. Different operating companies have got different attitudes to this issue, some are very sympathetic to the owner's concerns and they will be very flexible in terms of the owners needs. Other operating companies basically deliver an edict from head office and expect each hotel around the world to just follow the rules, irrespective of the impact on the economic circumstances of each particular hotel.

The ease by which operators can engage in biasing of capital budgeting proposals also appears to vary depending on the type of hotel owner and, more specifically, whether they are public or private. Indeed, it appears that hotel management has a greater propensity to bias capital budgeting proposals when they are contracted to public hotel owners. GM2, for example, commented on his current involvement with a publicly listed developer owner:

You can get numbers to tell any story that you want to get a capital budgeting project through, but then you have to achieve what you said you can do …. I personally wouldn’t put my head on the block, but some people would, because ego would get in the way.

A further pertinent comment on the propensity of operator biasing of capital budgeting proposals was made by GM3, who commented on his current involvement with a publicly listed developer owner as follows:

With forecasts and budgets usually truth goes out the door … we might say do we want a realistic budget? Do we want a budget that we can take to the bank? Or do we want a budget that will give us the bonus next year? …. I mean, the onus is on the owner to go back and check up on you, but a lot of owners don't check and it's all about learning the people and learning what the owners want and will do. If they don’t check, it’s easy to make things look rosy. It all depends on what the motivation of the operator is. I mean, I can get somebody to come in here and give you a better profit this year, but three of four years down the track the property will be suffering more than the additional profit that we would have got for that year.

GM3’s comments suggest that, consistent with agency theory, where there is insufficient monitoring from owners, operators will exploit the situation and engage in self-serving behaviour. GM1, commenting on his current involvement with a private hotel owner appears to add further support to this view. He commented:

The owner is probably not even aware of the potential to manipulate figures and that sort of thing and if they are aware I don't think that they would think that we would do it … I mean, we don’t have to do it (i.e. bias and manipulate figures), because we prepare the proposals and the owners don’t check them.
Consistent with this observation, biasing of capital budgeting proposals appears to become more difficult where a hotel owner becomes involved (i.e. monitors) in the preparation of capital budgeting proposals. This may be only achievable, however, where the owner has a higher locus of power relative to the operator. AM6, for example, works on behalf of a hotel owner that has a very high locus of power relative to the operator and therefore becomes highly involved (i.e. high monitoring) in the preparation of capital budgeting proposals, which reduces the ability of the operator to bias capital budgeting proposals. He commented:

We like to get in there and get our hands dirty. I mean, we are a large general property trust and have got completely different motivations to the trophy hunters. I mean, they (trophy hunters) might sit there and be happy with a nil return over a period of time, but we can't afford to do that … We take an active role in the running of this hotel. I mean, if we don't like the way that they (i.e. the operator) part their hair, we can get rid of them (i.e. terminate the management contract) and we work with them and make them consult us and get our approval for just about everything on the capital budgeting side of things. This strategy means that the operator would have a hard time pulling the wool over our eyes.

On the other hand, GM3’s owners do not get too involved in the preparation of capital budgeting proposals, as they have a relatively weak locus of power relative to the operator. This allows GM3 to have a heightened ability to bias capital budgeting proposals due to the reduced monitoring function. He commented:

I have always worked for owners who only want to own a hotel and are not too worried about return (i.e. high net worth individuals/trophy hunters) and it has allowed me to run the hotel the way I want to run it because the owner never really gets too involved in the preparation of proposals … If I say it’s a good project, he usually believes me.

GM1 is another interviewee who has an owner with a relatively weak locus of power relative to the operator. He commented about how the lack of owner involvement in the preparation of capital budgeting proposals facilitates a heightened ability to bias capital budgeting proposals. He commented:

The owners in this hotel have a very varied background with very little experience in hotels. I mean, the way that the owner got their hotel experience is sort of through us and it is more of a recent thing that they have learnt off us from being involved with this hotel and so they don’t bother me much and I can prepare the proposals the way that I want without any fear of reprisal from the owners.

It is also noteworthy that some hotel operators are beginning to question the level of owner involvement in the preparation of capital investment project proposals for some types of capital expenditure. AM2, for example, commented:
With situations like personal security becoming a much bigger issue, you know, with bombs going off at the Hilton in Bali, and the whole issue of the protection of guests and staff. The issue of whether the owner should have a say in operators’ decisions to spend capital for security reasons is debatable. For example, whether they should install say, camera surveillance or new locking systems, whether this decision should even get to the owner? Or whether the operator should be able to say no, ‘it’s our contractual obligation not to be negligent in protecting the guests and the staff of the hotel so therefore, and there are some big bucks being spent here as well, we’re going to spend this money for this whole surveillance system and it’s just got to be spent’ and whether the owner should be able to have any say in that is debatable.

A further issue that appears to reduce operator’s biasing of capital budgeting proposals is whether a hotel owner reviews the proposals (i.e. a different dimension of owners monitoring operators to the dimension of owner involvement in the preparation of the capital budgeting proposals noted above), which again appears to be linked to the locus of power between hotel owner and operator. AM6, for example, working on behalf of an owner with a high locus of power relative to the operator, commented:

We don’t sit there and rely on the operators in every instance to tell us what has to and what does not have to be done. …. It's not about believing everything that is shoved down your throat by the operator. …. We will check up on them and compare our figures to theirs. This makes them have to be very careful in what they put in front of us, or else they will look stupid.

On the other hand, AM4 typically works on behalf of owners that do not request reviews of operator’s proposals and have a relatively weak locus of power relative to the operator. He commented:

My responsibility is to the owner. Look, if I go to the owner and say that the capital budgeting proposal looks okay, and if the owner has a lot of confidence in me, most of the time, the owner gets the request and sees that it all makes sense, so they will just sign it without really looking at it. So in this situation, I don’t really have to review things that much, but if the owner is a bit more knowledgeable and starts wanting reviews, then I start to have to be a lot more careful with regard to dotting the i’s and crossing the t’s, otherwise I will look like an idiot. I have to be able to make an informed decision that can be justified.

Failure of some owners to carefully review operator submitted capital budgeting proposals raises a question as to their accuracy and the degree of operator bias contained within. AM1 commented:

I think there are still some operators that may tell you that they’re doing the capital budgeting proposal preparation accurately, but they probably aren’t doing it in an informed way at all … I mean, the operator always tells me that they will make more money from proposed capital spending, but at the end of the day, all that usually
happens is that it maintains the market position of the hotel and preserves the current room rate … and we have seen owners fooled by that all the time.

Further scepticism over claimed capital budgeting proposal implications on room rates is evident in the following commentary provided by AM6:

If the operator tells me that a project will increase the room rate by $5, I don’t use that to justify my decision because I feel that it is fairly difficult to quantify any gain in a room rate.

On the same issue, O2, who worked for an unlisted trust commented:

Just because we are going to increase our room quality doesn’t necessarily mean that it will lift the room rate. … The operator will always say that the room rate will come up a bit, but usually all that happens is that it has no effect and just puts us in a comparable position to our competition down the road.

9.10 Impact of owner characteristics on strategic focus and timing of capital spending (research objective eight)

Hotel owner type was found to impact on the strategic focus and timing of capital spending. Short-term focussed owners, are, for example, likely to attach limited importance on maintaining the long-term integrity of a hotel and generally have preconceived ideas about when they will sell their hotel assets. For these types of owners, the projected timing of the asset sale is based on supply and demand forecasts as well as the expiry date of the management contract. Longer-term oriented owners, however, typically prefer to keep their money invested longer and are likely to support more capital spending throughout their entire investment period.

Almost all hotel owners also tend to limit capital spending late in their hotel ownership investment time horizon, because it can sometimes take two to three years for that spending to affect a hotel’s cash flow. AM 5, for example, commented:

Usually you will come in and reposition the asset, trying to get some increase and then sell it. But the owner has to sell it sooner rather than later, otherwise they will have to do another refurbishment.

Public hotel owners with many shareholders, however, appear to display a tendency to spread capital spending out as far as possible throughout their investment period so as to avoid the burden of any large cash flow outlay in any one year. L2, for example, commented:
Owners have to provide cash in the marketplace and they basically have to be able to provide a return that is commensurate with all of the other people in the same investment setting. Therefore capital spending really creates a major issue for them because they basically have to provide a stable return for the investors. For example, an owner might have to deliver a 7.5% return to the shareholders for the year and then on top of that, have enough money to complete required capital spending. So the timing of that capital spending puts a huge strain on the owners to clear that money, to inject that money into the hotel and still be able to deliver a 7.5% return to the shareholders. So owners try to spread the spending on capital out as far as possible so that they are not hit with a huge amount at any one time.

Most hotel owners, however, appear to have a good understanding that potential buyers may wish to convert their hotel to an alternative use, which may render any capital spending toward their end of an existing owner’s investment time horizon of no value to the incoming owner. O2 encapsulated the essence of this argument as follows:

The investment time horizon of an owner can definitely affect the timing of their capital spending and there are definitely a lot of buyers out there that price hotels differently if they have an alternative use. For this reason, many owners these days, toward the end of their investment period, refrain from capital spending because they know full well that these types of new buyers are out there and they will price the hotel differently and if they conduct high capital spending toward the end of their investment time horizon, they might well be throwing money away. A bit of risk management comes into the decision.

GM2 whose hotel was currently owned by a developer owner, who purchased the hotel with the view to demolish it and instead build apartments in four years time, commented:

The owners at this hotel are reluctant to spend money … they are reluctant to give me the money for capital spending because they are looking at on-selling the property. …. We had to fight for two years to get them to spend just a couple of thousand dollars … the place was just shocking … and the owners were reluctant and then they would look at it again (i.e. an operator proposal to spend) seriously and then they kept saying no. … So we felt that our property lost credibility in the marketplace, totally, because we were advertising that next year we will have a new product and it will be refurbished and it would go into the brochures and then it didn’t happen. …. If it happens once, you might get away with it, but if it happens twice, you just lose all of your credibility in the marketplace and that happened and that took a great deal of effort on our behalf to rebuild our credibility in the marketplace.

These comments highlight that owners nearing the end of their investment time horizon are motivated to refrain from capital spending. The merits of such an approach, however, could potentially work against an incoming owner who might wish to continue the current hotel’s operations but have to confront a potential loss of credibility in the marketplace through the hotel being too run-down.
The timing of capital spending can also depend on the market for selling hotels at the end of an owner’s investment time horizon. For example, if the market is strong at the time of selling a property, purchasers are more likely to pay a premium for a hotel that is in particularly good condition. O1, a long-term oriented owner, for example, commented:

It is in our net interest to maintain the asset reasonably well, but we monitor how we spend capital relative to the market cycle, because if the market is very weak, you may not want to refurbish because it might not make any difference when you sell. If the market is strong, you might have to do the refurbishment to maintain the competitiveness of the hotel and get a better price.

Although O1 is not a short-term oriented owner, he made comment about the way in which he has seen short-term oriented owners react to the same issue. He commented:

Some short term owners basically come in and speculate and they are not necessarily natural hotel owners and they might only hold the hotel for two or three years and just play the market cycle and in most cases they spend very little on the asset. On the other hand, there are short-term oriented opportunity funds that buy a hotel that is run down and they come in, reposition it by spending $10 or $15 million and sell it. … All of it depends on the cycle of the market though.

Adding further weight to the above comments, AM4 noted that:

You have to read the market. I mean, this goes back to looking at what is the market going to be like when you sell the property. If the market is likely to be strong at the end when you sell the property, then people are more likely to pay a higher premium for a hotel that is in particularly good condition. There might, on the other hand, be the buyer that is looking to buy a rundown asset, flip it around, or re-badge it, or do something different with it. So if I were to buy a top-of-the-line, 5-star, hotel that is in immaculate condition I would probably want to keep it that way. However, if I were to buy a rundown 4-star hotel, then I could carry out a fairly large amount of capital spending to bring it up to a 5-star level, renegotiate and enter another management contract, then I would have a completely repositioned asset, only because I could spend the capital the way I wanted it to be spent. So horses for courses, there is no necessarily right or wrong answer to what the objectives of a hotel owner should be depending on their time horizon. The capital spending strategy depends to a large degree on what the hotel market is like at the time that the hotel owner wishes to sell the property as to what type of investment strategy they will adopt with regard to capital spending, therefore capital spending is not related to the type of hotel owner and more related to an owner’s investment objectives rather than time horizons.

These comments suggest that despite the differing objectives of long-term and short-term focused hotel owners, the overriding factor determining the timing of capital spending is the state of the hotel property market. Whenever an owner makes a conscious decision to not
carry out planned capital spending, however, it comes at a cost to their existing operations. FC2 commented:

You can't really just say that you are not going to spend the capital and continue on, because the result is that the repairs and maintenance bill is going to go up, and your property operating expenses are going to go up, and if the money isn’t spent, the future value of the entity as a going concern will go down, and that would be picked up in the financials, because of your product deterioration and the resulting loss of revenue.

These comments highlight the need for hotel owners to balance their capital spending toward the end of their investment period between the expected benefits to be gained by not spending, relative to the impact that a deteriorating product might have based on the market conditions for selling hotel properties at the time.

With regard to the state of play on the issue at present in Australia, the market appears particularly weak, because there is an apparent trend for hotel owners to be reaping rewards for hotels that are in poor condition as a result of a lack of infrastructure investment, particularly on the Gold Coast. One of the main drivers for this situation is that there has been increasing hotel ownership by property developers who refurbish “tired properties” and then sell them off as strata titled apartments, because currently the residential market is stronger than the hotel market. GM3 working now for a developer owner commented:

There is the Legends, Sheraton, Holiday Inn, Paradise Resort, Versace. I mean, at least 20% of the hotels on the Gold Coast are now owned by developer owners. The only negative with having a lot of developer owners in the industry is that there is the question of ‘are they just care-taking the industry until they can find a better thing to do with it?’ And does that mean from a long-term point of view that the size of the hotel industry is going to shrink?

Despite the questions raised with respect to this increasing trend for hotel developers to acquire hotels, these comments signify that hotel infrastructure spending by an owner who is planning to sell their hotel could be wasted, as a new property developer owner would not reward the previous owner’s expenditure if they are harbouring plans to refocus the building’s usage.

9.11 Conclusion

Drawing on the data provided in interviews with twenty key hotel stakeholders representing six different groups from fourteen organisations, this chapter has provided an initial empirical
analysis into seven of the study’s eight research objectives. The broad findings of the chapter indicate that the locus of power between hotel owners and operators is constantly evolving. Currently, the locus of power appears to be 60:40 in favour of owners. With regard to FF&E reserves, Australian hotels choose between cash, notional or no FF&E reserve. The choice is typically governed by the relative locus of power between the owner and operator. The majority of Australian hotel management contracts were found to provide for an increasing scale of FF&E reserve contributions during the first three to five years of a hotel’s operations. This then levels out to a contribution of around three per cent of gross revenue. Higher reserve allocations of up to five percent of gross revenue are made for resort hotels, where location specific factors can contribute to high levels of property deterioration. Despite these allocations, reserves tend to be under-funded in Australia for a range of reasons. The majority of Australian management contracts also create a legal obligation on owners to release funds from the FF&E reserve to enable operators to undertake budgeted FF&E projects. A further important finding from the interviews is that there always appears to be an element of qualitative decision-making orientation when making hotel investment decisions. Potential biasing of capital budgeting proposals by operators was also found to be a source of varying concern among different hotel owners.

It has also been noted that operators are typically inclined to positively bias capital budgeting proposals so that projects that protect their brand, give customers a consistent experience and raise their management fees are promoted. The ease by which operators can engage in biasing of capital budgeting proposals appears to be dependent on type of hotel owner. Finally, with regard to the strategic focus and timing of capital spending, for short-term focussed owners, the projected timing of the asset sale is based on supply and demand forecasts as well as the expiry date of the management contract. Longer-term oriented owners are more likely to support more capital spending throughout their entire investment period. Almost all hotel owners, however, were found to limit capital spending late in their hotel ownership investment time horizon, because it can sometimes take two to three years for capital expenditure to affect a hotel’s cash flow. Drawing on the interview findings presented in this chapter and also the literature reviewed earlier, the next chapter outlines issues addressed in the questionnaire survey phase of the study.
CHAPTER 10
PROPOSITION DEVELOPMENT

10.1 Introduction

Drawing upon material presented in the literature review and the interview findings’ chapters as well as by applying ‘a priori’ reasoning, this chapter describes the propositions that have been developed for testing using quantitative data collected by a questionnaire survey. The chapter begins by providing a diagrammatic overview of the propositions developed. Seven models are developed, which are based on the seven dependent variables investigated. Following this, the rationale for each of the propositions developed is provided in a manner structured by the seven models. This approach has resulted in some repetition of concepts, as some areas of the literature are needed to explain more than one proposition. Nevertheless, the approach was thought appropriate to ensure that all propositions are fully discussed in a sequential manner.

10.2 Proposition development

Twenty-three propositions in connection with a total of seven dependent variables have been developed. A diagrammatic overview of the proposed relationships is presented in models 1 through 7, which are depicted in Figures 10.1 to 10.7.
FIGURE 10.1
Model 1: Length of hotel management contract

<table>
<thead>
<tr>
<th>Proposition number</th>
<th>Independent variable</th>
<th>Dependent variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposition 1</td>
<td>Locus of power between hotel owner and operator</td>
<td>Length of hotel management contract</td>
</tr>
</tbody>
</table>

FIGURE 10.2
Model 2: Choice of FF&E reserve accounting approach

<table>
<thead>
<tr>
<th>Proposition number</th>
<th>Independent variable</th>
<th>Dependent variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposition 2</td>
<td>Locus of power between hotel owner and operator</td>
<td>FF&amp;E reserve accounting approach applied</td>
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</tbody>
</table>

FIGURE 10.3
Model 3: Adequacy of funds allocated to the FF&E reserve account

<table>
<thead>
<tr>
<th>Proposition number</th>
<th>Independent variable</th>
<th>Dependent variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposition 3a</td>
<td>Locus of power between hotel owner and operator</td>
<td>Adequacy of funds allocated to the FF&amp;E reserve account</td>
</tr>
<tr>
<td>Proposition 3b</td>
<td>Age of hotel property</td>
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</tbody>
</table>

FIGURE 10.4
Model 4: Hotel owner propensity to release FF&E reserve account funds

<table>
<thead>
<tr>
<th>Proposition number</th>
<th>Independent variable</th>
<th>Dependent variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proposition 4a</td>
<td>Locus of power between hotel owner and operator</td>
<td>Hotel owner propensity to release FF&amp;E reserve account funds</td>
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<tr>
<td>Proposition 4b</td>
<td>Ego-trip ownership</td>
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</table>
FIGURE 10.5
Model 5: Sophisticated quantitative capital budgeting technique usage

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<tr>
<th>Proposition number</th>
<th>Independent variable</th>
<th>Dependent variable</th>
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</thead>
<tbody>
<tr>
<td>Proposition 5a</td>
<td>Hotel operating with a management contract</td>
<td>Sophisticated quantitative capital budgeting technique usage</td>
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<tr>
<td>Proposition 5b</td>
<td>Hotel owner involvement in the capital budgeting process</td>
<td></td>
</tr>
<tr>
<td>Proposition 5c</td>
<td>Size of hotel owner</td>
<td></td>
</tr>
<tr>
<td>Proposition 5d</td>
<td>Public vs. private hotel owner</td>
<td></td>
</tr>
<tr>
<td>Proposition 5e</td>
<td>Size of hotel property</td>
<td></td>
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</tbody>
</table>
FIGURE 10.6
Model 6: Emphasis attached to quantitative versus qualitative investment appraisal techniques

<table>
<thead>
<tr>
<th>Proposition number</th>
<th>Independent variable</th>
<th>Dependent variable</th>
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</thead>
<tbody>
<tr>
<td>Proposition 6a</td>
<td>Public vs. private hotel owner</td>
<td>Emphasis attached to quantitative vs. qualitative investment appraisal techniques</td>
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<tr>
<td>Proposition 6b</td>
<td>Hotel operating with a management contract</td>
<td></td>
</tr>
<tr>
<td>Proposition 6c</td>
<td>Size of hotel owner</td>
<td></td>
</tr>
<tr>
<td>Proposition 6d</td>
<td>Locus of power between hotel owner and operator</td>
<td></td>
</tr>
<tr>
<td>Proposition 6e</td>
<td>Hotel owner involvement in the capital budgeting process</td>
<td></td>
</tr>
<tr>
<td>Proposition 6f</td>
<td>Size of hotel property</td>
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</table>
### FIGURE 10.7
Model 7: Propensity of hotel management to positively bias capital budgeting proposals

<table>
<thead>
<tr>
<th>Proposition number</th>
<th>Independent variable</th>
<th>Dependent variable</th>
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<tbody>
<tr>
<td>Proposition 7a</td>
<td>Hotel operating with a management contract</td>
<td>Propensity of hotel management to positively bias capital budgeting proposals</td>
</tr>
<tr>
<td>Proposition 7b</td>
<td>Locus of power between hotel owner and operator</td>
<td>Propensity of hotel management to positively bias capital budgeting proposals</td>
</tr>
<tr>
<td>Proposition 7c</td>
<td>Public vs. private hotel owner</td>
<td>Propensity of hotel management to positively bias capital budgeting proposals</td>
</tr>
<tr>
<td>Proposition 7d</td>
<td>Remaining length of hotel management contract</td>
<td>Propensity of hotel management to positively bias capital budgeting proposals</td>
</tr>
<tr>
<td>Proposition 7e</td>
<td>Hotel owner involvement in the capital budgeting process</td>
<td>Propensity of hotel management to positively bias capital budgeting proposals</td>
</tr>
<tr>
<td>Proposition 7f</td>
<td>Size of hotel property</td>
<td>Propensity of hotel management to positively bias capital budgeting proposals</td>
</tr>
</tbody>
</table>
10.2.1 Model 1: Length of hotel management contract

Model 1 depicted in Figure 10.1 suggests that locus of power between hotel owner and hotel operator affects hotel management contract length. The literature chapters highlighted that as a result of the agency issues that arise from the separation of ownership and management in hotels governed by a management contract (see e.g. Schlup, 2004), operators continually strive to increase the value of their brand and the longevity (i.e. length) of their management contracts held in order to secure a longer guarantee of business and to increase the number of rooms under their management (Beals & Denton, 2005; Haast, et al., 2006; Schiff, 2006). On the other hand, owners usually have a desire to put their limited resources into projects that will maximise bottom-line returns (Beals & Denton, 2005; Schiff, 2006). As hotel owners typically assume full economic risk associated with ownership of their asset, and operators are only responsible for the operation of the hotel (Schlup, 2004), operators tend to favour the security of long-term management contracts, whereas owners typically prefer the flexibility afforded by shorter-term management contracts. It is to be expected that the stakeholder with the strongest bargaining position will tend to negotiate a hotel management contract that favours their perspective (Rushmore, 2002). As hotel owners have gained more power in their relations with operators in recent times, they have been better positioned to negotiate shorter management contract periods (see Barge & Jacobs, 2001; Eyster, 1997a; Haast, et al., 2005; Horwath & Horwath, 1988; Panvisavas & Taylor, 2006; Sangree & Hathaway, 1996). The interview findings supported this position. Proposition 1 is worded in a manner consistent with the expectation that hotel owners with more power will tend to negotiate shorter management contracts.

**Proposition 1:** Owners with more power negotiate relatively short management contracts.

10.2.2 Model 2: Choice of FF&E reserve accounting approach

Model 2 depicted in Figure 10.2 suggests that locus of power between hotel owner and hotel operator affects the FF&E reserve accounting approach applied. The literature suggested that the majority of hotel management contracts require the owner to establish an FF&E reserve, which can be either cash or notionally (i.e. non-cash) funded (Haast, et al., 2005). Operators typically prefer the additional commitment of a cash reserve, while owners prefer notional reserves due to a desire to maintain control of their FF&E reserve money until it is required.
to finance expenditure (Haast, et al., 2005). This view was supported by observations made during the exploratory interviews where it also appeared that the choice between cash and notional FF&E reserve accounting approaches is affected by the relative locus of power between the owner and operator.\(^1\) Proposition 2 is worded in a manner consistent with this expectation.

**Proposition 2: Owner dominated management contract hotels make low use of cash funded FF&E reserves.**

10.2.3 Model 3: Adequacy of funds allocated to the FF&E reserve account

Model 3 depicted in Figure 10.3 suggests that the locus of power between hotel owner and hotel operator, and the age of a hotel property affects the adequacy of funds allocated to the FF&E reserve account. With regard to the affect of locus of power on the adequacy of funds allocated to the FF&E reserve account, the literature search highlighted that the FF&E reserve should have sufficient funds to cover future replacements on an ‘as needed’ basis, while at the same time, not allow excess funds to accumulate, as this can reduce profitability (Rushmore, 2002). Since the 1930s, however, there has been a general rule of thumb whereby three per cent of annual gross revenue is assigned to the FF&E reserve after ramping up (Brooke & Denton, 2007; Phillips, 2003; Ransley & Ingram, 2001). Today, however, it appears that the majority of hotel owners and operators see three per cent as insufficient to fund FF&E expenditure, as it ignores plant life cycles, routine maintenance costs and the aging of a building (Ferguson & Selling, 1985; Ransley & Ingram, 2001; Reichardt & Lennhoff, 2003). Nevertheless, many hotel owners persist with allocating only three per cent to the FF&E reserve. Much of the reason for this is that, hotel owners see any higher allocations and the associated larger accumulation of FF&E reserves as potentially undermining a rigorous appraisal of the need for FF&E expenditure (Higley, 2005c; Phillips, 2003). It appears hotel owners therefore have a preference for low FF&E reserve contributions, while, operators prefer high FF&E reserve contributions. As a result, there can be a tension between owner and operator on this issue (Eyster, 1997a; H. M. Field, 1995; Guilding, 2003; Rushmore, 2001). The interview findings suggest that conditions favourable

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\(^1\) Interviewee comments suggested that around 5% of Australian hotel management contracts have no FF&E reserve. Given the small number of hotels having no FF&E reserve, no proposition has been developed in connection with the no FF&E reserve accounting approach.
for owners succeeding in pursuing their preference for low FF&E reserve allocations arise
where the owner is experienced and the operator has no capital invested in the hotel. It
appears reasonable to expect that the way these competing preferences will play out will be
affected by the relative locus of power between owner and operator. Where owners have a
high locus of power, they will be able to negotiate lower allocations to the FF&E reserve.
Proposition 3a is worded in a manner consistent with this expectation.

**Proposition 3a:** Owner dominated management contract hotels will make lower allocations
to FF&E reserve accounts.

The second factor that is proposed to affect the adequacy of funds allocated to the FF&E reserve account is the age of a hotel property. The literature indicates that the general rule of
thumb of setting aside three per cent of annual revenues to the FF&E reserves is insufficient
(Ferguson & Selling, 1985; Ransley & Ingram, 2001; Reichardt & Lennhoff, 2003) as it
ignores the ageing of a hotel property (Brooke & Denton, 2007; Mellen, et al., 2000). Over a
twenty-five year period, for example, allocating only three percent of gross revenues annually
to the FF&E reserve is sufficient for only the first five years of a hotel’s operations (Brooke
& Denton, 2007; Mellen, et al., 2000). Proposition 3b is worded in a manner consistent with
this expectation.

**Proposition 3b:** FF&E reserve allocations are viewed as more inadequate in older hotel
properties.

10.2.4 Model 4: Hotel owner propensity to release FF&E reserve account funds

Model 4 depicted in Figure 10.4 suggests that the locus of power between hotel owner and
hotel operator and ego ownership affects a hotel owner’s propensity to release FF&E reserve
account funds. The literature search revealed that the release of funds from FF&E reserves is
typically subject to owner approval (Aghion, et al., 1994; Eyster, 1997a; H. M. Field, 1995;
Guilding, 2003; Horwath & Horwath, 1988; Rushmore, 2002). Nevertheless, some of the
more recently negotiated management contracts now specify that owners are to provide
sufficient FF&E funding to maintain the hotel at a ‘brand standard’, which often means that
greater than three per cent of gross revenue must be allocated to and released from the FF&E
reserve so as to avoid an owner having their affiliation with a hotel brand discontinued
through termination of the management contract (Beals, 2004; Beals & Denton, 2005; Crandell, et al., 2004; Dickson, 2007; Dickson, et al., 2008; Haast, et al., 2005). The interview data confirmed that many management contracts in Australia include a ‘brand standard maintenance’ legal obligation clause requiring the owner to release funds from the FF&E reserve. If a hotel fails to meet the brand standard, as documented in the management contract, then the operator can terminate the contract. The interview findings revealed, however, that operators will only seldom seek to terminate a management contract on the basis of inadequate release of funds from the FF&E reserve, as it can often lead to an overall loss of reputation and profitability for the operating company. Despite this, as the operator’s degree of accessibility to funds recorded in the FF&E reserve can be a major source of friction between owners and operators (Australia New Zealand & Pacific Hotel Investment Conference, 2006a), it is expected that the propensity of a hotel owner to release funds from the FF&E reserve will be affected by the locus of power between hotel owner and operator. Proposition 4a is worded in a manner consistent with this expectation.

**Proposition 4a:** There is a lower propensity for the hotel owner to release FF&E reserve funds in owner dominated hotels.

The second factor that is proposed to affect a hotel owner’s propensity to release FF&E reserve account funds is ego-trip ownership. Motivation for this proposition comes from Guilding (2006, p. 415) who noted that ego-trip ownership “appears to be closely related to an ostentatious desire to own a lavish hotel decorated with expensive furniture and fittings.” As a result, where ego-trip ownership is present, it is expected that the operator will find it easier to get a hotel owner’s support for proposed FF&E expenditure. Proposition 4b is worded in a manner consistent with this expectation.

**Proposition 4b:** Ego-trip owners have a high propensity to release FF&E reserve funds.

10.2.5 Model 5: Sophisticated quantitative capital budgeting technique usage

Model 5 depicted in Figure 10.5 identifies five factors affecting the usage of sophisticated quantitative capital budgeting techniques. The first independent variable to affect the usage of sophisticated quantitative capital budgeting techniques is whether a hotel operates with a management contract. It is noteworthy that the literature includes a view that the use of
sophisticated capital investment appraisal techniques can lead to the ultimate decline of a firm (Hayes & Abernathy, 1980; Hayes & Garvin, 1982). This is because the environment often does not have enough predictability and certainty for sophisticated capital investment appraisal techniques to work efficiently (Chen, 1995; Grundy & Johnson, 1993; Haka, 1987; Mouck, 2000). The significant amount of subjectivity in calculating inputs to sophisticated capital budgeting appraisal techniques can also lead to managerial self-serving bias (Miller, 1978; Tole, et al., 1997). Quantitatively based sophisticated techniques can therefore be subject to manipulation by agents and can increase the degree of information corruption (Marino & Matsusaka, 2005). The use of sophisticated capital budgeting appraisal techniques can also create high information costs associated with explaining the meaning and implications of more complex models (e.g. NPV & IRR) as compared to a simple model (e.g. payback & AARR) (Collier & Gregory, 1995a).

As a result of the heightened agency issues that arise from the separation of ownership and management under hotel management contracts (Guilding, et al., 2001; Lynch, 2002; Schlup, 2004), it could be in a hotel owner’s interest to mandate that hotel management make greater use of simple capital investment appraisal techniques in the analysis of capital budgeting proposals in order to reduce the likelihood of hotel management acting in self-interest. Contrary to this argument, however, is Guilding’s (2003) view that highlights that where hotels operate under management contracts, capital budgeting is made more complex because the decision to invest has to cross the organisational divide between owner and operator. For this reason, Guilding feels that hotels operating under management contracts will tend to employ more formalised capital budgeting procedures. With regard to Guilding’s (2003) meaning of ‘formalisation of the capital budgeting process’, he explained that the capital budgeting process is formalised where there is high “systematic study of issues” (Langley, 1990, p. 17) as well as importance attached to the use of quantitative analysis using methods such as NPV, IRR, payback, and ROI (Van-Cauwenbergh, et al., 1996). As already noted earlier, Guilding (2003) found support for his position in qualitative interview data collected from hotel general managers and financial controllers of large Australian hotels. Conflicting arguments are therefore apparent with respect to whether hotels operating with a management contract will make greater use of sophisticated capital budgeting appraisal techniques. Given

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2 Recall that payback, average accounting rate of return (both simple), net present value (NPV) and internal rate of return (IRR) (both sophisticated) are the four most widely appraised methods in prior surveys of investment appraisal practice (see Damitio & Schmidgall, 2002; Lamminmaki, et al., 1996; J. D. Payne, et al., 1999; 1996).
that Guilding’s (2003) qualitative interview findings on the issue are most closely related to this study, it is expected that management contract operated hotels will make greater use of sophisticated quantitative capital budgeting techniques. Proposition 5a is worded in a manner consistent with this expectation.

**Proposition 5a:** Hotels with management contracts make greater use of sophisticated quantitative capital budgeting techniques.

The second independent variable proposed to affect the usage of sophisticated quantitative capital budgeting techniques is the degree of hotel owner involvement in the capital budgeting process. The management style of hotel owners, for example, can affect the relative sophistication of capital budgeting appraisal techniques used (Collier & Gregory, 1995a). Where a principal adopts a ‘hands on’ approach to the preparation of capital budgeting proposals, this is typically accompanied by the use of less sophisticated capital budgeting appraisal techniques (Collier & Gregory, 1995a). A potential reason for this could be that principals are typically aware that agents face incentives to maximise their own self-interest at the expense of the owner’s interests when preparing capital budgeting proposals (Reimann, 1990; Ruhl & Cowen, 1992). Given the significant amount of subjectivity in calculating inputs to sophisticated capital budgeting appraisal techniques, use of less sophisticated capital budgeting appraisal techniques could reduce managerial self-serving bias (Marino & Matsusaka, 2005; Miller, 1978; Tole, et al., 1997). Greater owner involvement in a hotel’s capital budgeting process can therefore make it more difficult for operators to act in self-interest (Gannon & Johnson, 1997). Where principals are involved in the preparation of capital budgeting proposals, they are also typically better positioned to reduce the amount of asymmetric information and therefore to reduce the information advantage that agents have over them (Antle, et al., 1999). Evidence also suggests that in owner controlled firms, there is often a much stronger positive relationship between earnings and capital investment than in manager-controlled firms (Sunder, 1980). This highlights that where an owner becomes more involved in the preparation of capital budgeting proposals, the resulting investment is typically more aligned with their own interests as compared to the interests of the agent. A limiting factor for hotel owners, however, is that as the level of information asymmetry between owner and operator increases (Baiman & Lewis, 1989; Baiman & Sivaramakrishnan, 1991; Waller, 1988) the ability of the owner to effectively participate in the preparation of capital budgeting proposals is reduced (F. Collins & Manion, 159
In decentralised settings, for example, agents generally provide greater input to the preparation of capital expenditure proposals (Chandler, 1977; Dulman, 1989). On the other hand, in centralised investment settings, owners typically approve all investment projects and also require that a certain rate of return be achieved for a project to go ahead (Horngren, et al., 2000). The situation of an operator holding an asymmetrical information advantage over an owner, however, can be counteracted through the owner incurring higher monitoring costs (M. Harris & Raviv, 1996). Many principals, however, do not have the time to observe all the decisions and actions of agents (Statman, 1982). For this reason, in many management contract operated hotels, owners are increasingly engaging asset managers to act on their behalf and provide this monitoring function (Armitstead, 2004; Swing, 2004) which can facilitate a more productive alignment of interests between the owner and operator (Capital Hotel Management, 2006b; Feldman, 1995; Geller, 2002). Based on the rationale drawn from the literature, it is expected that as hotel owners become more involved in the capital budgeting process, there is a reduced usage of sophisticated quantitative capital budgeting techniques. Proposition 5b is worded in a manner consistent with this expectation.

**Proposition 5b:** Greater hotel owner involvement in the capital budgeting process leads to a reduced use of sophisticated quantitative capital budgeting techniques.

The third independent variable proposed to affect the usage of sophisticated quantitative capital budgeting techniques is the size of the hotel owner. Guilding (2003) suggests that large hotel owners make greater use of formalised capital budgeting procedures, which include sophisticated capital budgeting appraisal techniques. The literature also holds that larger hotels make greater use of sophisticated techniques such as NPV and IRR (Guilding and Lamminmaki, 2007). The following proposition has been postulated in a manner consistent with these findings.

**Proposition 5c:** Large owners make greater use of sophisticated quantitative capital budgeting techniques.

The fourth independent variable proposed to affect the usage of sophisticated quantitative capital budgeting techniques is whether the hotel owner is public or private. On this issue, the literature highlighted that whether an organisation is publicly traded or privately held can
influence the sophistication of capital investment appraisal techniques adopted. It appears that in publicly traded firms, sophisticated capital investment techniques tend to dominate (Farragher, 1986; Kim & Farragher, 1981; Pike, 1985). This is despite the fact that some argue that simple capital investment appraisal techniques, such as payback, can effectively maximise shareholder wealth (Statman & Sepe, 1984). There is evidence that private unlisted firms tend to make a relatively low overall use of quantitative capital investment appraisal techniques (Holmes & Nicholls, 1988). A potential reason for this is that justification of the discount rates applied in sophisticated capital budgeting procedures are based on the separation principle (i.e. that investment decisions can be made independent of shareholders’ preferences), which does not always hold for closely-held smaller firms (McInish & Kudla, 1981). In light of this literature, it is expected that public hotel owners will make greater use of sophisticated quantitative capital budgeting techniques.

**Proposition 5d:** Public hotel owners make greater use of sophisticated quantitative capital budgeting techniques.

The fifth independent variable proposed to affect the usage of sophisticated quantitative capital budgeting techniques is hotel property size. The literature suggests that company size is positively related to capital investment appraisal technique sophistication (Block, 1997; Danielson & Scott, 2006; Graham & Harvey, 2001; Guilding & Lamminmaki, 2007; Kocher, 2007; Lamminmaki, et al., 1996; Patterson, 1989; Pike, 1996; D. Smith & Wynne, 2006). Proposition 5e is worded in a manner consistent with this expectation.

**Proposition 5e:** Large hotels make greater use of sophisticated quantitative capital budgeting techniques.

10.2.6 Model 6: Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal

Model 6 depicted in Figure 10.6 identifies six factors affecting emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques. The first independent variable is whether the hotel owner is public or private. The interview findings suggest that public hotel owners make greater use of quantitative capital budgeting appraisal techniques. A large proportion of owners of publicly traded hotel companies are institutional investors, a
factor that tends to promote a culture of formalised and quantitatively-based investment
decision making.3 Institutional investors also differ from individual (or private) investors
because they are typically better informed and better placed to effectively monitor the
performance of corporate managers (Oak & Dalbor, 2008). Privately held hotel ownership
entities, however, were found to place greater importance on a qualitative orientation in
investment appraisal, such as gut feel, intuition, instinct, experience and knowledge. Part of
the reason for this is that in privately held hotel ownership entities there is a greater tendency
for investment decisions to be driven by the owner’s ego, as the owner will impart their own
judgements, views and tastes when managing the hotel. Proposition 6a is worded in a manner
consistent with this expectation.

**Proposition 6a:** Relative to private hotel owners, public hotel owners make greater use of
quantitative techniques in investment appraisal.

The second independent variable proposed to affect emphasis attached to quantitative versus
qualitative capital budgeting appraisal techniques is whether the hotel operates with a
management contract. The literature search revealed the view that hotels operating under
management contracts typically make greater use of formalised capital budgeting procedures
(Guilding, 2003). This observation, combined with a priori reasoning, suggests that hotels
operating with a management contract will make greater use of quantitative techniques in
investment appraisal than non-management contract hotels. Proposition 6b is worded in a
manner consistent with this expectation.

**Proposition 6b:** Hotels operating with a management contract make greater use of
quantitative techniques in investment appraisal than non-management contract hotels.

The third independent variable to affect the emphasis attached to quantitative versus
qualitative capital budgeting appraisal techniques in investment appraisal is the size of the
hotel owner. The literature highlights that large hotels typically make greater use of
formalised capital budgeting procedures, which include the use of more quantitative capital

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3 Interviewees saw institutional shareholders as including investment banks, insurance companies and
superannuation funds. These comments concur with the literature, which suggests that the following types of
owner can be viewed as ‘institutional’: lenders (Davis & DeRoos, 2004), mutual funds (Firth, 1995; Heisler,
Knittel, Neumann, & Stewart, 2007), investment banks (Bielski, 2005; Norwell & Mambirino, 2006; Oak &
Dalbor, 2008), insurance companies (Firth, 1995; Oak & Dalbor, 2008; Stewart, 2007), superannuation funds
(Hollowell, 2006; Oak & Dalbor, 2008) and bank trusts (Clyde, 1997).
budgeting appraisal techniques (Guilding, 2003). The interview data also found that public hotel owners make greater use of quantitative capital budgeting appraisal techniques than private hotel owners and are generally larger than private hotel owners. Proposition 6c is worded in a manner consistent with this view.

**Proposition 6c:** In hotels that are owned by large hotel owners, greater emphasis is attached to quantitative techniques in investment appraisal.

The fourth independent variable proposed as affecting the emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal is the locus of power between hotel owner and hotel operator. The literature highlights that in management contract hotels, larger owners typically make greater use of formalised capital budgeting procedures, which includes the use of more quantitative capital budgeting appraisal techniques (Guilding, 2003). The interview findings further highlight that large hotel owners typically have more power in owner / operator relationships. As it is the owner who has to finance capital expenditures, they can be expected to seek that the operator prepares a thorough quantitative analysis for all capital expenditures proposed. The ability of the owner to force their will on the operator will be greater when the owner has dominance in the relationship. This rationale suggests greater owner power will result in the owner requiring the preparation of well-documented quantitatively-based justifications of investment proposals. Proposition 6d is worded in a manner consistent with this expectation.

**Proposition 6d:** Dominant hotel owners will require a high emphasis on quantitative techniques in investment appraisal.

The fifth independent variable proposed as affecting emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal is the degree of hotel owner involvement in the capital budgeting process. It has already been noted that where a principal adopts a ‘hands on’ approach to capital budgeting proposal preparation, this is typically accompanied by the use of less sophisticated capital budgeting appraisal techniques (Collier & Gregory, 1995a). This could be because principals have an awareness that agents face incentives to maximise their self-interest at the expense of the owner’s interests when preparing capital budgeting proposals (Reimann, 1990; Ruhl & Cowen, 1992). Given the significant amount of subjectivity in calculating inputs to sophisticated capital
budgeting appraisal techniques, use of less sophisticated capital budgeting appraisal techniques could reduce managerial self-serving bias (Marino & Matsusaka, 2005; Miller, 1978; Tole, et al., 1997). Greater owner involvement in the hotel’s capital budgeting process can therefore make it more difficult for operators to act in self-interest (Gannon & Johnson, 1997). It is also the case that where principals are involved in the preparation of capital budgeting proposals, they are typically better positioned to reduce the amount of asymmetric information and therefore to reduce an agent’s information advantage (Antle, et al., 1999). Evidence also suggests that in owner controlled firms, there is a stronger positive relationship between earnings and capital investment than in manager-controlled firms (Sunder, 1980). This highlights that where the owner becomes more involved in the preparation of capital budgeting proposals, the resulting investment is typically more aligned with their own interests as compared to the interests of the operator. A limiting factor for hotel owners, however, is that as the level of information asymmetry between owner and operator increases (Baiman & Lewis, 1989; Baiman & Sivaramakrishnan, 1991; Waller, 1988), the ability of the owner to participate in the preparation of capital budgeting proposals is reduced (F. Collins & Manion, 1994; Dunk & Perera, 1997; G. J. Fisher, et al., 2000). In decentralised settings, for example, agents provide greater input to the preparation of capital expenditure proposals (Chandler, 1977; Dulman, 1989). On the other hand, in centralised investment settings, owners typically approve all investment projects and also require that a certain rate of return be achieved for a project to go ahead (Horngren, et al., 2000). The situation of an operator holding an asymmetrical information advantage over an owner, however, can be counteracted through the owner incurring higher monitoring costs (M. Harris & Raviv, 1996). Many principals, however, do not have the time to observe all the decisions and actions of agents (Statman, 1982). For this reason, in many management contract operated hotels, owners are increasingly engaging asset managers to act on their behalf to provide this monitoring function (Armitstead, 2004; Swing, 2004), which can facilitate a more productive owner/operator alignment of interests (Capital Hotel Management, 2006b; Feldman, 1995; Geller, 2002). In light of this discussion, it is expected that as hotel owners become more involved in the capital budgeting process, there is greater use of qualitative capital investment appraisal techniques. Proposition 6e is worded in a manner consistent with this expectation.

Proposition 6e: Greater owner involvement in the capital budgeting process leads to greater use of qualitative capital investment appraisal techniques.
The sixth independent variable proposed to affect the emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal is the size of a hotel property. An enduring finding in the literature is a positive association between company size and capital budgeting sophistication (see e.g. Block, 1997; Danielson & Scott, 2006; Graham & Harvey, 2001; Kocher, 2007; Lamminmaki, et al., 1996; Patterson, 1989; Pike, 1996; D. Smith & Wynne, 2006). Also, Danielson and Scott (2006) found that smaller organisations have a greater likelihood of applying qualitative capital budgeting appraisal techniques. A potential reason for this is that in smaller firms, owners sometimes have limited educational backgrounds relative to owners of larger firms (Danielson & Scott, 2006). Proposition 6f is worded in a manner consistent with this expectation.

**Proposition 6f:** Large hotels make greater use of quantitative techniques in investment appraisal.

10.2.7 Model 7: Propensity of hotel management to positively bias capital budgeting proposals

Model 7 depicted in Figure 10.7 identifies six factors affecting the propensity of hotel management to positively bias capital budgeting proposals. Positively biasing capital budgeting proposals means inflating projected revenues and deflating projected expenditures. The first independent variable proposed as affecting the propensity of hotel management to positively bias capital budgeting proposals is whether the hotel operates with a management contract. The literature suggests that in hotel management contractual arrangements, the agency issues that arise between owners and operators due to the separation of ownership and management (Schlup, 2004) creates a volatile mix of economics and power that can explode because of the differing time horizons of the two parties (Beals, 1995; Beals & Denton, 2005). Operators, for example, are typically interested in achieving short-term cash flows, while hotel owners tend to be more focused on the achievement of longer-term goals (Guilding, et al., 2001; Lynch, 2002). The literature also suggests that capital budgeting decisions are not always made in the interests of principals because agents often select capital budgeting projects that further their self-interest (Arya, et al., 1998; Bower, 1986; Chaney & Lewis, 1995; Haka, 2007; Kida, et al., 2001; Moreno, et al., 2002; Moyer, et al., 2001; Mukherjee & Henderson, 1987; Pinches, 1982; Reimann, 1990; Ruhl & Cowen, 1992; Rutledge & Karim, 1999; Staw, 1976; Welker, 1995; Zhang, 1997).
Where hotels operate under management contracts, capital budgeting is rendered more complex because the decision must cross an organisational divide in order to satisfy the investment appraisal criteria of both the owner and operator (Guilding, 2003). In this situation, Guilding (2003) notes that operators might try to inflate projected cash inflow estimates in capital budgeting proposals so as to persuade the owner to make an investment. Guilding (2003) also notes that negative cash flow data biasing may occur where an owner attaches significant importance to metering outputs rather than monitoring behaviour. Such a metering approach could involve monitoring an operator’s performance relative to investment proposal forecasts (Guilding, 2003). Guilding (2003, p. 194) also suggests, however, that there are two factors that give hotel operators in management contract operated hotels an incentive to be relatively “bullish” (i.e., inflate projected revenues and deflate projected expenditures associated with investment proposals). The first of these factors arises from the fact that it is the owner who bears the main burden of a failed capital expenditure project. Secondly, Guilding (2003) comments that the method of remuneration of the operator (i.e. typically a base fee tied to gross revenue, and an incentive fee tied to a percentage of gross operating profit) means that operators face incentives to promote projects that have high total revenue and high total profit, with little regard to the return on these investments. Guilding’s (2003) empirical findings found stronger support for a propensity to positively bias rather than to negatively bias capital budgeting proposals.

Proposition 7a is worded in a manner consistent with Guilding’s (2003) finding that hotel management in hotels governed by a management contract will have a greater propensity to positively bias capital budgeting proposals than hotel management in non-management contract hotels.

**Proposition 7a:** Hotel management in hotels operating with a management contract have a relatively high propensity to positively bias capital budgeting proposals.

The second independent variable proposed as affecting the propensity of hotel management to positively bias capital budgeting proposals is the locus of power between hotel owner and operator. The interview findings highlighted that where operators hold a high locus of power relative to the owner, the ability of hotel owners’ to become involved in the preparation of capital budgeting proposals and also to require revisions of proposals is restricted. It therefore
appears likely that operators with high power will have a high capacity to positively bias capital budgeting proposals. Proposition 7b is worded consistent with this rationale.

**Proposition 7b:** Operator dominated management contract hotels have a heightened propensity to positively bias capital budgeting proposals.

The third independent variable proposed as affecting the propensity of hotel management to positively bias capital budgeting proposals is whether the hotel owner is public or private. The literature highlighted that in public organisations, managers have a greater tendency to overstate the true potential of projects and therefore over-invest (Danielson & Scott, 2007). It is therefore expected that hotel management contracted to public hotel owners will have more of a license to positively bias capital budgeting proposals. Proposition 7c is worded consistent with this expectation.

**Proposition 7c:** Hotel management contracted to public hotel owners have a relatively high propensity to positively bias capital budgeting proposals.

The fourth independent variable proposed to affect the propensity of hotel management to positively bias capital budgeting proposals is the length of time remaining on a management contract. It has already been noted that in hotel management contractual arrangements, agency issues arise between owners and operators due to the separation of ownership and management (Schlup, 2004), which can become a problem in the presence of differing time horizons of owners and operators (Beals, 1995; Beals & Denton, 2005). Capital budgeting decisions are therefore not always made in the interests of the principal because agents often select capital budgeting projects that further their self-interest (Arya, et al., 1998; Bower, 1986; Chaney & Lewis, 1995; Haka, 2007; Kida, et al., 2001; Moreno, et al., 2002; Moyer, et al., 2001; Mukherjee & Henderson, 1987; Pinches, 1982; Reimann, 1990; Ruhl & Cowen, 1992; Rutledge & Karim, 1999; Staw, 1976; Welker, 1995; Zhang, 1997). Long-term contracts can often assist in mitigating inconsistent principal/agent interests (Antle & Fellingham, 1990; Haka, 1987; Larker, 1983). Indeed, Guilding (2003) suggests that where operators wish to establish a long-term relationship with the owner, they will be more likely to engage in an underestimation of cash flows. On the other hand, operators nearing the end of their management contracts and with a diminished desire to renew the contract would be more likely to engage in overestimation of cash inflows. It is therefore expected that longer-
term management contracts reduce the propensity of hotel management to positively bias capital budgeting proposals. As the time until expiry of a management contract reduces, the operator has an increasing incentive to act in a short-termist manner. Proposition 7d is worded in a manner consistent with this expectation.

**Proposition 7d:** The shorter the time to expiry of a management contract, the greater the propensity of hotel management to positively bias capital budgeting proposals.

The fifth independent variable proposed to affect the propensity of hotel management to positively bias capital budgeting proposals is the degree of hotel owner involvement in the capital budgeting process. As outlined earlier, the literature highlights that operators face incentives to maximise their own self-interest at the expense of the owner’s interests when preparing capital budgeting proposals (see e.g. Reimann, 1990; Ruhl & Cowen, 1992). Greater owner involvement in the hotel’s capital budgeting process can make it more difficult for operators to act in self-interest (Gannon & Johnson, 1997). Supporting this view, it has been found that low owner involvement in the preparation of capital budgeting proposals often leads to agents overspending (Marino & Matsusaka, 2005). Indeed, Guilding (2006) explains that where owners become more involved in the preparation of capital budgeting proposals, they typically initiate such investments and the opportunity for operators to bias capital budgeting proposals is therefore reduced. It is also notable that where principals are involved in the preparation of capital budgeting proposals, they are better positioned to reduce the amount of asymmetric information and therefore to reduce the information advantage that can be experienced by agents (Antle, et al., 1999). Proposition 7e is worded in a manner consistent with the expectation that greater owner involvement in the capital budgeting process reduces operator cash flow projection biasing.

**Proposition 7e:** High owner involvement in the capital budgeting process will lead to a low propensity for hotel management to positively bias capital budgeting proposals.

The sixth independent variable proposed to affect the propensity of hotel management to positively bias capital budgeting proposals is the size of a hotel property. The literature highlights that the size of an organisation can impact on the propensity of hotel management to positively bias capital budgeting proposals. In small firms that are typically closely held, evidence suggests that there is a greater likelihood for management to understate the true
potential of projects and therefore under-invest (Danielson & Scott, 2007). On the other hand, in larger organisations that typically have a wider dispersion of ownership, managers have a tendency to overstate the true potential of projects and therefore over-invest (Danielson & Scott, 2007). The reason for this is as follows:

When the ownership and control of a small firm are closely linked, each new investment has the potential to introduce agency conflicts into the firm. For example, the expansion of a firm’s operations can require decision-making authority to be delegated to employees, creating agency conflicts between employees and owners. Or, new investments can require external financing from third parties. If so, agency problems can develop between the entrepreneur and other equity-holders, or between debt- and equity-holders … the desire to avoid the costs of such conflicts can complicate the investment decisions of small firms. … Once growth has created a separation of ownership and control, the entrepreneur [owner] must establish planning approval, and monitoring systems, to guard against the possibility that employees will advocate inappropriate (or unnecessary) projects. Thus, many small firms must choose between accepting more stringent (voluntary or involuntary) capital constraints – perhaps leading to underinvestment – and incurring the costs necessary to control agency costs (Danielson & Scott, 2007, pp. 173-174).

Proposition 7f is worded in a manner consistent with these observations.

**Proposition 7f:** Management in large hotels have a greater propensity to positively bias capital budgeting proposals.

**10.3 Conclusion**

This chapter has developed specific propositions that will be tested using data collected in the questionnaire survey phase of the study. Twenty-three propositions pertaining to seven dependent variables have been developed. Rationale for each of the propositions drawn from the literature, interview findings and *a priori* reasoning has been provided. The next chapter describes the development of questionnaire measures for the independent and dependent variables and also the overall design of the questionnaire.
CHAPTER 11
MEASURES AND QUESTIONNAIRE DESIGN

11.1 Introduction

The purpose of this chapter is to introduce the questionnaire survey questions that have been used to measure the independent and dependent variables outlined in the propositions presented in the previous chapter. This chapter will begin by providing an overview of general issues in questionnaire design and pilot testing. Following this, a description of the measures used will be provided in the order that they appear in the questionnaire. Finally, a concluding commentary of the chapter will be presented.

11.2 Questionnaire design

The questionnaire used in this study was sent to general managers of Australian hotels and New Zealand hotels with twenty or more rooms and a star rating of three or more. It is important to note that although the primary focus of this study is on the asset related expenditure practices of Australian hotels, general managers of New Zealand hotels were also targeted with the questionnaire survey in an attempt to increase the number of usable responses derived and also to allow for the possibility of cross-country comparison. The broad similarity of the Australian and New Zealand culture and history (see Samson & Ford, 2000; Simms, 2006), economic and governmental systems (see Bjorksten, Karagedikli, Plantier, & Grimes, 2004; Groenewold, 1997; Malik, 2004), hospitality based educational training and research environment (see Coles, Hall, & Duval, 2006), labour systems (see M. Barry & Wailes, 2005; Campbell & Brosnan, 2005; Lansbury, Wailes, & Yazbeck, 2007) and accounting standards (see Nino, 2007; Robb & Newberry, 2007; Scott, 2002) mean that there is little reason to anticipate major differences in the asset related expenditure practices of Australian and New Zealand hotels.

The questionnaire was sent to general managers as they were seen as holding the requisite knowledge required to complete the questionnaire and comprised a large enough group to enable the collection of sufficient responses to enable a robust analysis. General managers

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1 A letter of ethics approval from Griffith University to conduct the questionnaire survey as outlined in this chapter is presented in appendix E.
were also seen as being “well placed to observe any ‘cross-fire’ between a hotel owner and operator” (Guilding, 2006, p. 405). As part of an attempt to achieve a high response rate, it was felt desirable to keep the questionnaire to a reasonable size. The questionnaire was limited to four A4 pages. Accompanying the questionnaire in the mail-out was a covering letter (see appendix G) and a flyer highlighting that the study has been endorsed by three leading hotel consultancy companies (see appendix A).

### 11.2.1 General issues in questionnaire design

Likert scale questions were adopted wherever possible as this enables a more advanced data analysis relative to categorical measurement scales. Commenting on management accounting research, Brownell (1995) explains that Likert scales are the most commonly used multiple-item scales because they are easy to construct and they can also handle multi-dimensionality.

Based on these comments and to be consistent with other recent hotel capital budgeting based research (see e.g. Guilding & Lamminmaki, 2007), seven-point Likert scales were adopted in the current study. Following the advice of Hinkin (1995), no double barrel questions were used, nor reverse scored items. In an attempt to reduce respondent fatigue or response bias, care was taken to limit the number of questions posed (Hinkin, 1995).

With regard to questionnaire questions requiring categorical responses, although there is some evidence that the inclusion of ‘NO’ options can be beneficial (Bogart, 1972; Converse & Presser, 1986; S. L. Payne, 1950; Vaillancourt, 1973), no ‘NO’ options have been provided. This is because the benefits of ‘NO’ options are typically limited to situations where respondents have limited cognitive skills (G. F. Bishop, Oldendick, & Tuchfarber, 1980; Gergen & Back, 1965; Narayan & Krosnick, 1996; Singelman, 1981). People who are more knowledgeable about a particular topic are typically better equipped to form relevant opinions and are less likely to provide ‘NO’ responses (Faulkenberry & Mason, 1978; Krosnick & Milburn, 1990; Leigh & Martin, 1987; Rapoport, 1981, 1982). Also, where people are more interested in a topic, they will be more likely to form an opinion on it (Francis & Busch, 1975; Krosnick & Milburn, 1990; Norpoth & Buchanan, 1992; Rapoport, 1979, 1982; Wright & Niemi, 1983). In addition, the greater a person’s perception of their ability to process and understand information, the less likely they are to record a ‘NO’ response (Krosnick & Milburn, 1990). Taken together, these factors suggest that general
managers would be unlikely to provide a ‘NO’ response to the type of questions posed in the questionnaire.

11.3 Questionnaire piloting

Fourteen academics and six practitioners piloted the questionnaire. Table 11.1 provides an overview of the backgrounds of these individuals.

<table>
<thead>
<tr>
<th>TABLE 11.1</th>
<th>Background of individuals who piloted the questionnaire</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Academics</td>
</tr>
<tr>
<td>Accounting academics</td>
<td>4</td>
</tr>
<tr>
<td>Hotel academics</td>
<td>6</td>
</tr>
<tr>
<td>Accounting and hotel academics</td>
<td>4</td>
</tr>
<tr>
<td>Specialist statistical survey academics</td>
<td>2</td>
</tr>
<tr>
<td>Industry experts</td>
<td>3</td>
</tr>
<tr>
<td>Hotel general managers</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td>16</td>
</tr>
</tbody>
</table>

The academics came from a variety of backgrounds, which was considered pertinent so as to gain a wide range of comments. Consistent with the recommendations of Brownell (1995), the survey instrument was also reviewed by experts in survey methods. Several iterations of the questionnaire were piloted. The feedback from the industry experts and general managers was particularly important so as to ensure that the questionnaire was comprehensive yet concise, relevant and easy to understand.

Piloting was achieved by firstly providing a copy of the questionnaire to the reviewers. Following this, telephone discussions, and, where possible, face-to-face meetings were carried out where the individual concerned was asked to comment on the questionnaire’s layout, the relevance and appropriateness of questions and any ambiguities. Changes made to the questionnaire, as a result of piloting, included:

1. In question 4, it was considered important to add demographic data concerning the number of years that the general manager had been at the property.
2. Although originally scheduled as Question 8, Question 20 was moved as it was thought likely to promote a better response.
3. The general layout of the questionnaire changed. Originally there was considerable use of bold text. During pilot testing this was found to be too difficult to read and was therefore removed.

11.4 Questionnaire measures

In order to test the twenty-three propositions that were outlined in the previous chapter, fifteen measures need to be developed. To do this, thirty-three questions were posed in the questionnaire survey. Two of these questions were directed toward gathering important background information. The questionnaire was sub-divided into three main sections. The first section gathered hotel background information. The second section related to factors concerning hotel capital budgeting and the third section was completed only by respondents who worked in hotels governed by management contracts.

Table 11.2 provides an overview of the proposition variables and their measurement. The first column outlines the name of the particular variable. The second column states the type of variable (i.e. independent variable, dependent variable or descriptive variable). The third column identifies the study’s research proposition that the variable relates to. The fourth column records the questionnaire numbers used to measure the variable and the final column provides details of prior studies that have measured the particular variable.

---

2 Note that three of the questionnaire items (i.e. Questions 3, 32 and 33) were concerned with the gathering of data in connection with additional research being that is being conducted by the researcher outside this thesis.
<table>
<thead>
<tr>
<th>Variable</th>
<th>Type of variable</th>
<th>Propositions</th>
<th>Q’naire items</th>
<th>Prior studies measuring variable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ownership / management structure</td>
<td>Independent</td>
<td>5a, 6b, 7a</td>
<td>2</td>
<td>Guilding (2003); Lamminmaki (2003)</td>
</tr>
<tr>
<td>Type of hotel owner</td>
<td>Research variable</td>
<td>-</td>
<td>3</td>
<td>-</td>
</tr>
<tr>
<td>Age of hotel property</td>
<td>Independent</td>
<td>3b</td>
<td>4a</td>
<td>International Society of Hospitality Consultants (2007)</td>
</tr>
<tr>
<td>Years general manager has been in their current position</td>
<td>Descriptive</td>
<td>-</td>
<td>4b</td>
<td>McManus (2006)</td>
</tr>
<tr>
<td>Public vs. private hotel ownership</td>
<td>Independent</td>
<td>5d, 6a, 7c</td>
<td>5</td>
<td>Newell and Seabrook (2006); Tzovas (2006)</td>
</tr>
<tr>
<td>Size of hotel property</td>
<td>Independent</td>
<td>5e, 6f, 7f</td>
<td>6</td>
<td>Guilding and Lamminmaki (2007); Vallen and Vallen (2005); Garcia-Falcon and Medina-Munoz (1999)</td>
</tr>
<tr>
<td>Size of hotel owner</td>
<td>Independent</td>
<td>5c, 6c</td>
<td>7</td>
<td>Haast et al. (2006)</td>
</tr>
<tr>
<td>Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal</td>
<td>Dependent</td>
<td>6a, 6b, 6c, 6d, 6e, 6f</td>
<td>8 - 9</td>
<td>Adapted from a qualitative discussion by Butler, Davis, Pike, and Sharp (1993) as well as prior studies by Kamath and Oberst (1992) and Porwal and Singhvi (1978)</td>
</tr>
<tr>
<td>Propensity of hotel management to positively bias capital budgeting proposals</td>
<td>Dependent</td>
<td>7a, 7b, 7c, 7d, 7e, 7f</td>
<td>10-12</td>
<td>Guilding and Lamminmaki (2007); Pruitt and Gitman (1987)</td>
</tr>
<tr>
<td>Ego-trip ownership</td>
<td>Independent</td>
<td>4b</td>
<td>13 - 15</td>
<td>-</td>
</tr>
<tr>
<td>Category</td>
<td>Type</td>
<td>Variables</td>
<td>Range</td>
<td>References</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>-----------------------</td>
<td>-----------</td>
<td>--------</td>
<td>----------------------------------------------------------------</td>
</tr>
<tr>
<td>Owner involvement in the capital budgeting process</td>
<td>Independent variable</td>
<td>5b, 6e, 7e</td>
<td>16-19</td>
<td>Adapted from Milani (1975)</td>
</tr>
<tr>
<td>Emphasis attached to sophisticated quantitative capital budgeting techniques</td>
<td>Dependent variable</td>
<td>5a, 5b, 5c, 5d, 5e</td>
<td>20</td>
<td>Guilding and Lamminmaki (2007)</td>
</tr>
<tr>
<td>Length of hotel management contract</td>
<td>Dependent variable</td>
<td>1</td>
<td>21</td>
<td></td>
</tr>
<tr>
<td>Remaining length of hotel management contract</td>
<td>Independent variable</td>
<td>7d</td>
<td>22</td>
<td></td>
</tr>
<tr>
<td>FF&amp;E reserve accounting approach applied</td>
<td>Dependent variable</td>
<td>2</td>
<td>23</td>
<td></td>
</tr>
<tr>
<td>Adequacy of funds allocated to the FF&amp;E reserve account</td>
<td>Dependent variable</td>
<td>3a, 3b</td>
<td>24-26</td>
<td></td>
</tr>
<tr>
<td>Hotel owner propensity to release FF&amp;E reserve funds</td>
<td>Dependent variable</td>
<td>4a</td>
<td>27-29</td>
<td></td>
</tr>
<tr>
<td>Locus of power between hotel owner and hotel operator</td>
<td>Independent variable</td>
<td>1 2 3a 4 6d, 7b</td>
<td>30-31</td>
<td>Adapted from Hinkin and Schriesheim (1989); Bachman, Smith, and Slesinger (1966); Yukl and Falbe (1991)</td>
</tr>
<tr>
<td>Owner and operator tendency to seek to capitalise or expense asset related expenditure</td>
<td>Research being conducted outside of thesis</td>
<td>-</td>
<td>32-33</td>
<td></td>
</tr>
</tbody>
</table>
The following sections discuss each of the questionnaire items in greater detail in the order that they appear on the questionnaire survey. A copy of the questionnaire survey instrument is available in appendix G.

11.4.1 Section A – Hotel background information (Questions 1 – 7)

Section A comprises two styles of question. Questions 1, 5, 6 and 7 seek to obtain numerical discrete information, while Questions 2, 3 and 4 are categorical. A number of these questions are considered ‘soft’ (i.e., non invasive). Asking such questions in this first section of a questionnaire can potentially have a positive impact on the response rate (Andrews, 1984). The following sections outline the nature and development of each of these questions in greater detail.

11.4.1.1 Star-rating of hotel (Question 1)

Star-rating is a commonly measured variable in hotel research (see e.g. C. L. Burgess, 2003; Guilding & Lamminmaki, 2007; Harrington & Keating, 2006; McKay, Clack, Batchelor, Astbury, & Teerapittayapaisan, 2002; Nebel, Braunlich, & Zhang, 1994). A recent study to have measured the star-rating of Australian hotels was carried out by Guilding and Lamminmaki (2007). The current study used Guilding and Lamminmaki’s (2007) measure of star-rating by asking the respondent: “What is the star-rating of your hotel?” As outlined in Table 11.1, hotel star-rating is used as a descriptive variable in the study.

11.4.1.2 Ownership / management structure (Question 2)

The literature highlighted that the main methods of hotel ownership are the independent owner-operator, franchise and management contract arrangements (Gannon & Johnson, 1997). Two studies (see e.g. Guilding, 2003; Lamminmaki, 2003) have measured whether a hotel operates with a management contract. Question 2 goes a step further that these studies, however, as it asks the respondents to choose between the three methods outlined above as opposed to a yes/no answer. To prevent confusion between the three choices, respondents were provided with short definitions of each term. The definitions for management contracts and franchises were drawn from Garcia-Falcon and Medina-Munoz (1999, p. 106), which were based on Angelo and Vladimir (1994), Kasavana and Brooks (1995), Knowles (1996).
and Vallen and Vallen (1999). The definition for independently owned and operated hotels was based on Field’s (1995) work. An “other” option was also provided in case there were any additional categories of hotel owner that were not picked up in the literature or the interview findings. If a respondent chose this “other” option, they were asked to describe the nature of the owner / management structure.

11.4.1.3 Age of hotel property (Question 4a)

After an extensive literature search, the only studies found to have measured the age of a hotel property using a questionnaire survey were those conducted by Mellen, Nylen and Pastorino (2000) and Brooke and Denton (2007). Within these studies, the questionnaire posed the statement “Year built”. Within the current study, this question was modified to read: “Approximately how many years old is your hotel?”

11.4.1.4 Number of years the general manager has been in their current position (Question 4b)

As indicated earlier, during the piloting phase it was thought pertinent to include a descriptive question aimed at gathering demographic data concerning the number of years the general manager had been in the position he/she currently occupied. A prior study to have sought such data was carried out by McManus (2006), who asked “Your length of employment: in current position ____ years”. Adapting this, Question 4b asked the respondent “Approximately how many years have you been GM at this property?”

11.4.1.5 Public or private hotel ownership (Question 5)

Studies that have measured the public versus private hotel owner categorisation in questionnaire surveys (Brooke & Denton, 2007; Mellen, et al., 2000; Newell & Seabrook, 2006; Tzovas, 2006) typically use a categorical response format. The current study takes this approach but also offers the respondent brief definitions of what a ‘public’ and ‘private’ hotel owner are. The definition of a ‘public’ hotel owner was adapted from Wallace and Cossar (2005) to include the words “Shares traded on stock exchange”. The definition of a ‘private’ hotel owner was adapted from Brown et al. (2006) to include the words “No shares publicly traded”. Question 5 therefore asked the respondent “Which of the following best describes
the nature of your hotel owner’s entity? Please tick.” The respondent was offered the choice of ticking either “Public: shares traded on the stock exchange” or “Private: no shares publicly traded”.

11.4.1.6 Size of hotel property (Question 6)

Although there are other possibilities, such as acres of land, number of employees, annual sales turnover or net profits (Vallen & Vallen, 2005), the number of rooms in a hotel is the most commonly accepted measure of a hotel’s size (Garcia-Falcon & Medina-Munoz, 1999; Vallen & Vallen, 2005). Of the other possibilities, it appears that annual sales turnover is another widely adopted measure of a hotel’s size (see Guilding & Lamminmaki, 2007; Lamminmaki, et al., 1996; Property Council of Australia, 2003). As a result, it was felt prudent that both measures be used to measure a hotel’s size. Question 6 therefore had two sub-parts.

To determine the number of rooms in a hotel, questionnaire measures are typically categorical (see e.g. Kasavana & Brooks, 1995; Vallen & Vallen, 2005) or discrete (see e.g. Guilding & Lamminmaki, 2007). In light of the advantages of discrete data, respondents were asked in part A of question 6: “What is the approximate size of your hotel? a) number of rooms: ___”.

Part B of Question 6 sought to measure annual sales turnover and made use of Guilding and Lamminmaki’s (2007) discrete measure by asking the respondent “What is the approximate size of your hotel? b) annual sales turnover: AUD$ ___ million”

11.4.1.7 Size of hotel owner (Question 7)

Little empirical academic research was found that had attempted to measure the size of a hotel owner. Industry publications such as Haast et al. (2006, p. 24), however, typically use the number of rooms owned as a measure of a hotel owner’s size. The interview findings also highlighted, however, that in addition to the number of rooms owned, a further measure of a hotel owner’s size is the number of hotels that they own. For this reason, it was thought pertinent to use both measures. Question 7 therefore asked “What is your hotel owner’s approximate size? Please specify”, and then asked the respondent to indicate the “Number of
hotels owned (i.e. worldwide): ____” and also the “Number of hotel rooms owned (i.e. worldwide): ____”.

11.4.2 Section B – Factors affecting hotel capital budgeting proposals (Questions 8 – 20)

All questions in section B involve seven-point Likert scale measures. Respondents were asked to “please circle appropriate number using the scale provided”.

11.4.2.1 Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal (Questions 8 - 9)

An extensive literature search revealed no prior research investigating the emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques using a questionnaire survey. To determine the emphasis attached to the quantitative element of this construct, there is a large literature concerned with quantitative capital budgeting appraisal techniques (see e.g. Kester, et al., 1999; Lamminmaki, et al., 1996; Pike, 1996). There are a small number of studies (see e.g. Kamath & Oberst, 1992; Porwal & Singhvi, 1978) that have investigated the use of qualitative factors in capital budgeting decision making using questionnaire surveys. Kamath and Oberst (1992), for example, assessed the impact of qualitative factors on hospital capital budgeting by asking their sample of hospital general managers to rank ten qualitative factors specific to hospital capital budgeting. Porwal and Singhvi (1978) used factors such as employee relations and competitive position in a study of large manufacturing firms in India. These studies reveal, however, that measures of the emphasis attached to qualitative capital budgeting appraisal techniques are often context specific. As a result, it would appear appropriate that the current study employs a context specific measurement approach.

Butler et al. (1993) noted that qualitative capital budgeting appraisal techniques typically fall into three main categories: (1) strategic factors, which are concerned with ensuring that capital investment projects deliver a competitive advantage (see also Emblemsvag & Endre Kjolstad, 2002; Lefley, 2004; Lefley & Sarkis, 1997; Proctor & Canada, 1992); (2) risk factors, which primarily involve political considerations; and (3) performance factors, which involve the exercise of managerial intuition and judgment (see also Chami & Fullenkamp,
It was noted earlier that in Guilding’s (2006) interviews of general managers and financial controllers in a sample of South East Queensland (Australia) hotels, four different perspectives associated with investment appraisal were noted: (1) financial analysis; (2) strategic analysis; (3) internal political factors; and (4) managerial intuition. The last three categories were viewed by Guilding (2006) as corresponding to Butler et al.’s (1993) three categories: ‘strategic factors’, ‘risk factors’, and ‘performance factors’ respectively.

Using the categories of qualitative capital budgeting appraisal developed by Butler et al. (1993) and Guilding (2006), as well as the prior questionnaire based research of Kamath and Oberst (1992) and Porwal and Singhvi (1978) as a foundation, questions aligned to three categories of qualitative capital investment appraisal factors were posed in a context specific manner.

Question 8 comprises twelve items that relate to Butler et al.’s (1993) three qualitative capital investment appraisal factors and also the use of quantitative capital budgeting appraisal techniques. Table 11.3 provides an overview of Question 8. The first column identifies Butler et al.’s (1993) capital budgeting appraisal technique categories. The second column summarises Guilding’s (2006) capital budgeting appraisal technique categories, which are also adopted in this study. The third column identifies elements derived from the literature. The fourth column provides the item number and the fifth column provides details of the question posed. For all of Question 8’s items, a seven-point Likert-type scale with 1 being ‘not at all’ and 7 being ‘to a large extent’ was used.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Quantitative</td>
<td>Financial analysis</td>
<td>Payback, AARR, NPV and IRR: as espoused by Ballantine and Stray (1999); Butler et al. (1993); Haka et al. (1985); Klammer (1972); Pike (1983).</td>
<td>a</td>
<td>The proposal is justifiable on financial grounds</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>j</td>
<td>Cash flow and profitability forecasts support the proposal’s viability.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>l</td>
<td>The project’s budget provides a good financial return.</td>
</tr>
<tr>
<td>Strategic factors</td>
<td>Strategic analysis</td>
<td>To ensure that project delivers competitive advantage to the firm: as espoused by Emblemsvag and Endre Kjolstad (2002); Lefley (2004); Lefley and Sarkis (1997); Proctor and Canada (1992).</td>
<td>b</td>
<td>The proposal can be justified on the basis of gaining marketplace competitive advantage.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>c</td>
<td>The proposal is justified by a thoroughly conducted strategic analysis (e.g. competitive positioning analysis, SWOT analysis).</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>i</td>
<td>The project represents an opportunity to pre-empt the competition.</td>
</tr>
<tr>
<td>Risk factors</td>
<td>Internal political factors</td>
<td>Involves political considerations in relation to a project’s sponsor: as espoused by Ackerman (1970); Cyert and March (1963)</td>
<td>e</td>
<td>The proposal’s main sponsor (i.e. the manager most closely associated with the project’s initiation and development) has a strong company track record.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>g</td>
<td>The manager acting as the proposal’s sponsor is a shrewd negotiator.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>h</td>
<td>The manager acting as the proposal’s sponsor understands internal politics and uses this to their advantage in seeking company approval.</td>
</tr>
<tr>
<td>Performance factors</td>
<td>Managerial intuition</td>
<td>Involves the exercise of managerial intuition and judgement: as espoused by Chami and Fullenkamp (2002); Dempsey (1996); Guilding and Lamminmaki (2007); Kay (1993); Maccarrone (1996); Moncarz and</td>
<td>d</td>
<td>The proposal appears justifiable on intuitive grounds.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>f</td>
<td>Experience suggests that the project will be successful.</td>
</tr>
<tr>
<td>Kron (1995); Mukherji and Nagarajan (1995); Tinsley et al. (2002).</td>
<td>k</td>
<td>On the face of it, the proposal makes sound commercial sense.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Further to posing Question 8, as there is a general lack of research concerning the emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques, it was thought pertinent to also pose a holistic question on the issue. To this end, question 9 was posed, which attempted to directly appraise the relative strength of the quantitative and qualitative investment appraisal orientations by asking the respondents to indicate their degree of agreement with the statement: “In my hotel, quantitative analysis is more important than qualitative analysis when appraising investment proposals” A seven-point Likert-type scale was used with 1 signifying ‘strongly disagree’ and 7 signifying ‘strongly agree’.

11.4.2.2 Propensity of hotel management to positively bias capital budgeting proposals (Questions 10 – 12)

After an extensive literature search, only two studies (see e.g. Guilding & Lamminmaki, 2007; Pruitt & Gitman, 1987) were found that had sought to determine the extent to which managers have a tendency to positively bias capital budgeting proposals using a questionnaire survey based method. For this reason, Questions 10 through 12 draw upon these two studies and adapt their questions to suit the context of the current study. Table 11.4 provides an overview of the questionnaire questions used to measure the propensity of hotel management to positively bias capital budgeting proposals. Within the Table, the first column gives the questionnaire item number. The second column provides details of the source of the question. The third column provides the original question and the fourth column provides the current study’s question. Within columns three and four, words in italics indicate how the original question has been adapted to the context of the current study. For all of Questions 10 through 12, a seven point Likert type scale was utilised with 1 being ‘strongly disagree’ and 7 being ‘strongly agree’.
<table>
<thead>
<tr>
<th>Q’naire Item</th>
<th>Author</th>
<th>Author’s original question</th>
<th>Current study’s question</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>Guilding and Lamminmaki (2007, p. 492)</td>
<td>In my hotel, there is a tendency for investment project sponsors (i.e. the managers most closely associated with the project’s initiation and development) to inflate projected cash inflow estimates in order to increase the likelihood of the project gaining senior management support.</td>
<td>In my hotel, there is a tendency for investment project sponsors (i.e. the managers most closely associated with the project’s initiation and development) to inflate projected cash inflow estimates in order to increase the likelihood of the project gaining the hotel owner’s support.</td>
</tr>
<tr>
<td>11</td>
<td>Pruitt and Gitman (1987, p. 48)</td>
<td>Revenue forecasts of capital budgeting proposals (not necessarily accepted projects) are typically overstated?</td>
<td>In my hotel, revenue forecasts of capital budgeting proposals (not necessarily accepted projects) are typically overstated.</td>
</tr>
<tr>
<td>12</td>
<td>Pruitt and Gitman (1987, p. 48)</td>
<td>Cost forecasts of capital budgeting proposals (not necessarily accepted projects) are typically understated?</td>
<td>In my hotel, cost forecasts of capital budgeting proposals (not necessarily accepted projects) are typically understated.</td>
</tr>
</tbody>
</table>
After an extensive literature search it appears that the only questionnaire based research that has sought to measure ego within the hotel industry is that carried out by Upchurch (1998a, 1998b). Upchurch’s questionnaires, however, were directed to hotel general managers and sought to determine “ethical egoism”, which is primarily concerned with the ethicalness (i.e. self-interest) of decisions made by a general manager (i.e. agent) (Upchurch, 1998a, p. 1349). The problem with using Upchurch’s measures in the context of the current study is that they were aimed at the general manager’s (i.e. agent’s) degree of ego displayed. In this study, however, it is the hotel owner’s (i.e. principal’s) ego that needs to be measured. As a result of hotel owners not being in an agency relationship with the general manager, the measures developed by Upchurch (1998a, 1998b) were considered inappropriate for adaptation in the current study. The literature concerning ego hotel ownership, however, was able to guide the development of three questions that have been developed.

With respect to Question 13, the literature highlighted that ego owners typically use their organisation as a “vehicle for satisfying personal ambitions” (Beaver & Jennings, 2005, p. 20). The underlying objective of an ego owner is to therefore gratify their desires, indulge in their emotions and to satisfy their wishes (Locke & Woiceshyn, 1995). Ego owners, for example, often spend copious amounts of time engaged in designing the look and feel of their hotel to suit their personal preferences (Baltin & Cole, 1995; Daneshkhu, 1998; Wagner, 1998). Based on these findings, ego owners can be expected to take considerable pride in the ownership of their hotel. Question 13 therefore posed the question “The owner of my hotel derives considerable pride from the hotel’s appearance” A seven point Likert type scale was utilised with 1 being ‘strongly agree’ and 7 being ‘strongly disagree’.

Question 14 is the second ego ownership question. As outlined in the literature review, Guilding (2006, p. 415) referred to “ego-trip ownership”. Question 14 therefore posed the question “Ownership of my hotel appears to provide an ego-trip for the owner” A seven point Likert type scale was utilised with 1 being ‘strongly agree’ and 7 being ‘strongly disagree’.

With regard to Question 15, Guilding (2006, p. 415) noted that “ego-trip oriented ownership appears to be closely related to an ostentatious desire to own a lavish hotel decorated with expensive furniture and fittings.” Canina (2001) also noted that ownership of hotels can
sometimes be based more on egotism than on hard financial analysis (Canina, 2001). Consistent with this literature Question 15 posed the question “To what extent was the owner’s purchase of your hotel motivated by financial versus ostentatious considerations?” A seven point Likert type scale was utilised with 1 being ‘mainly financial’ and 7 being ‘mainly ostentatious’.

11.4.2.4 Hotel owner involvement in the preparation of capital budgeting proposals (Questions 16 - 19)

After an extensive literature search, no prior research was found that had measured the amount of hotel owner involvement in the preparation of capital budgeting proposals. In the context of annualised budgeting, however, Milani’s (1975) six item budgetary participation questionnaire instrument, which measures the amount of influence an individual has on the budget as well as his or her involvement in the process of establishing the budget, has been widely used in studies focused on budgetary participation (see e.g. Agbejule & Saarikoski, 2006; Bento & White, 2006; Brownell, 1982a, 1982b, 1983; Brownell & Hirst, 1986; Brownell & McInnes, 1986; Chenhall, 1986; Chenhall & Brownell, 1988; Dunk, 1989; Gul, Tsui, Fong, & Kwok, 1995; Hirst & Yetton, 1999; Mia, 1988, 1989; Milani, 1975; Nouri & Parker, 1998; Parker & Kyj, 2006; Tsui, 2001).

Four of Milani’s (1975) six items of budgetary participation were adapted for use in this study. Two of Milani’s (1975) six items were dropped due to space considerations and because they were not considered to be as relevant as the remaining four measures. As part of the adaptation process, it must be recognised that Milani’s (1975) questionnaire instrument was designed to be administered to subordinates concerning the degree to which they participate in the budget setting process. Within the current study, however, general managers are being asked to comment about their hotel owner’s participation in the preparation of capital budgeting proposals. For this reason, questions in the current study were framed in an opposite manner to those posed by Milani (1975). Table 11.5 provides an overview of questions 16 through 19 as well as the two Milani (1975) items that were not used in the current study. Column one indicates the questionnaire item number. Column two outlines the

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3 Note that while Questions 16 to 19 were included within the second section the questionnaire, which was answered by all respondents, it was later decided that it was necessary to restrict the answers for this question to respondents operating with a management contract only.
six questions posed by Milani (1975). Column three shows the current study’s adaptations of Milani’s (1975) questions. The fourth column describes the seven point Likert type scale adopted for each question.
### TABLE 11.5
Overview of questionnaire questions 14 to 19 used to measure hotel owner involvement in the preparation of capital budgeting proposals

<table>
<thead>
<tr>
<th>Q'nai're Item</th>
<th>Elements of Milani’s (1975, p. 279) six item budgetary participation instrument</th>
<th>Current study’s question</th>
<th>Likert scale</th>
</tr>
</thead>
</table>
| 14           | The portion of the budget the subordinate was involved in setting?               | To what extent is your hotel owner involved in the hotel’s capital budgeting process? | 1 = Not at all  
                                    |                                                                                         | 7 = To a large extent                  |
| 15           | The frequency of budget-related discussions initiated by the subordinate?       | How often does your hotel owner initiate capital budgeting proposals without being asked? | 1 = Never  
                                    |                                                                                         | 7 = Very often                        |
| 16           | The amount of influence the subordinate felt he had on the final budget?        | How much influence do you feel your hotel owner has on the final approved capital budget in your hotel? | 1 = No influence  
                                    |                                                                                         | 7 = A great deal of influence        |
| 19           | The importance of the subordinate’s contribution to the budget?                 | How do you view your hotel owner’s contribution to the capital budgeting process? | 1 = Not substantial  
                                    |                                                                                         | 7 = Very substantial                 |
| Not used     | The frequency of budget-related discussions initiated by the subordinate’s superior when budgets are being set? | -                         | -            |
| Not used     | The kind of reasoning provided to the subordinate by a superior when the budget is revised? | -                         | -            |
11.4.2.5 Emphasis attached to sophisticated quantitative capital budgeting techniques (Question 20)

As noted by Guilding and Lamminmaki (2007), payback, net present value (NPV), average accounting rate of return (AARR), and internal rate of return (IRR) are the four most widely appraised methods in prior surveys of investment appraisal practice. The literature further suggests that payback and AARR are simple while NPV and IRR are sophisticated (see Ballantine & Stray, 1999; Butler, et al., 1993; Haka, et al., 1985; Klammer, 1972; Pike, 1983). In order to measure the emphasis attached to sophisticated versus simple capital budgeting appraisal techniques, the current study utilized the four item measure used by Guilding and Lamminmaki (2007). This asks respondents to indicate the extent to which their hotel uses each of the four capital budgeting appraisal techniques outlined above on a seven-point Likert-type scale with 1 being ‘not at all’, and 7 being ‘to a large extent’.

11.4.3 Section C – Issues arising from the use of hotel management contracts (Questions 21 – 33)

Section C gathers information in connection with factors arising from the use of hotel management contracts. Respondents whose hotels operated under a franchise or owner-operator structure were advised to not complete section C.

11.4.3.1 Length of hotel management contract (Question 21)

To measure the length of a hotel’s management contract, the respondent was asked “What was the original length of your management contract? ____ year(s)”.

11.4.3.2 Remaining length of hotel management contract (Question 22)

To measure the remaining management contract length, Question 22 asked the respondent “Approximately how long is it until your management contract expires? ____ year(s)”.
11.4.3.3 FF&E reserve accounting approach applied (Question 23)

No prior literature was found that had attempted to determine the FF&E reserve accounting approach applied by hotels using a questionnaire survey. The literature, however, highlighted that FF&E reserves can be either cash or notionally (i.e. non-cash) funded (Haast, et al., 2005). The interview findings also highlighted that a small percentage of hotels have no FF&E reserve. To determine the type of FF&E reserve accounting approach applied, Question 23 asked the respondent “What type of Furniture, Fittings and Equipment (FF&E) reserve accounting approach is used in your hotel? Please tick.” The categories that the respondents could choose from included: (1) “Cash”; (2) “Notional (non-cash)”; (3) “No FF&E reserve”; and (4) “Other”. Offering the “other” option was thought pertinent in case there were any additional FF&E reserve accounting approaches that were not identified in the literature review or interview findings.

11.4.3.4 Adequacy of funds allocated to the FF&E reserve account (Questions 24 – 26)

No prior questionnaire survey based research was found that had measured the adequacy of funds allocated to the FF&E reserve account. Question 24 asked “What percentage of gross revenue is allocated annually (after ramping up) to the FF&E reserve account in your hotel? ____%”. In an attempt to determine if there were different approaches to FF&E reserve accounting being used, Question 24 also asked “If FF&E reserve allocation is based on a different approach, please describe: ____”

Question 25 asked the respondent “To what extent do you consider the funds allocated to the FF&E reserve in your hotel are sufficient to fund FF&E expenditure?” A seven-point Likert scale was used with 1 being “not sufficient”, and 7 being “very sufficient”.

Question 26 asked the respondent “What percentage of gross revenue would be required to cover the true cost of reasonable annual FF&E expenditure in your hotel (after ramping up)? ____%”.

190
11.4.3.5 Hotel owner propensity to release FF&E reserve account funds (Questions 27 – 29)

No prior studies were found that had measured the propensity of hotel owners to release funds from the FF&E reserve account. Question 27 sought to determine the degree to which hotel owners make the release of FF&E reserve funds difficult by asking respondents to indicate the extent to which they agree with the statement: “In my hotel it can be hard to get the owner to release funds from the FF&E reserve” A seven-point Likert scale was used with 1 being “strongly disagree”, and 7 being “strongly agree”.

Question 28 set out to establish how often the owner actually refuses to release funds from the FF&E reserve by asking “How often does your hotel owner refuse to release funds from the FF&E reserve?” A seven-point Likert scale was provided with 1 being “never”, and 7 being “frequently”.

Question 29 determined the extent to which general managers have to pressurise their hotel owner to release funds from the FF&E reserve by asking “How much do you need to pressurise your hotel owner to get funds released from the FF&E reserve? A seven-point Likert scale was used with 1 being “not at all”, and 7 being “very much”.

11.4.3.6 Locus of power between hotel owner and hotel operator (Questions 30 - 31)

There is an extensive literature on organisational power. As no prior discussion of the issue of power between hotel owners and operators in a hotel management contract context using a questionnaire survey was found in the literature, a wide-ranging discussion concerning the development of an appropriate measure is given in this section. As outlined in the literature, at the organisational level, the study of power branches into three distinct but overlapping areas. These areas comprise: (1) the intraorganisational power literature, which studies power relationships between individuals within the same organisation (see Brass, 2002); (2) the organisational power literature, which studies the power of individuals and groups relative to their relationship with and their dependence on the organisation (see Ocasio, 2002); and (3) the interorganisational power literature, which studies power relationships between organisations (see Mizruchi & Yoo, 2002). The primary point of difference between the three power literatures concerns what actors are focussed on (Brass, 2002). For example, the actors
may be people (intraorganisational), groups (organisational), or organisations (interorganisational), which means that theories of power can be developed for all three dimensions of analysis (Brass, 2002). In the context of hotel management contracts, it would appear pertinent to guide the current study’s power measures by the interorganisational branch of power literature. A limitation of this branch of the power literature, however, is that there has been little empirical questionnaire survey based research (Mizruchi & Yoo, 2002). It appears, for example, that only two studies by Pfeffer and Salancik (1978) and Yan and Gray (2001) exist. There appear to be three common bases of interorganisational power, which include:

(1) An assessment of the alternative choices available to both organisations in the negotiation phase, whereby the more alternative choices an organisation has, the greater their power, because at any moment, they can threaten to walk away from the current negotiation and exercise their ‘BANTA’ (best alternative to a negotiated agreement) (R. Fisher & Ury, 1981).

(2) The strategic importance of the project to the organisations at the time of the negotiation. Within the joint venture literature, for example, the more strategically important a project is to an organisation at the time of the negotiation, the more dependence that the organisation will have on the project and the less power they will have relative to the other organisation (Bartlett & Ghoshal, 1986; Koza & Lewin, 1998);

(3) The contribution of capital versus non-capital resources to the arrangement by the organisations involved. Where an organisation contributes more capital resources (i.e. tangible assets such as buildings and machinery etc.) to the arrangement, they will typically have more capital based resource power (Chi, 1994). On the other hand, the organisation that contributes more non-capital resources (i.e. brands, expertise, marketing channels etc.) will have more non-capital based resource power (Chi, 1994).

When attempting to apply these three interorganisational power bases to the context of the current study, two major problems arise. The first problem concerns the particularities of the hotel management contract and the second problem is that it is the general manager who is being surveyed in the current study. These problems make the interorganisational power bases unsuitable for the current study. For example, with regard to the first and second interorganisational power bases listed, as hotel management contracts are typically entered
into for lengthy periods of time of ten years or more (see e.g. Barge & Jacobs, 2001; Eyster, 1997a; Haast, et al., 2005; Horwath & Horwath, 1988) and general managers typically have career paths that feature a high rate of mobility of their labour (Akrivos, et al., 2007; Ladkin & Riley, 1996; Riley & Ladkin, 1994), there is a low likelihood that the general manager filling out the questionnaire would be in a position to comment on the conditions that existed when the hotel management contract was originally negotiated between hotel owner and hotel operator. With regard to the third interorganisational power base listed above, the particularities of the hotel management contract make this base less important to the current study than would be the case in other organisational contexts. For example, there is potentially greater scope in joint ventures for the organisations involved to attach different strategic importance to a project due to the different responsibilities, experiences and assets that the organisations (i.e. partners) may bring to the relationship. Also, there would be a greater range of types of businesses being undertaken in joint ventures, which would also be a dynamic affecting their relationship. In a hotel management contract situation, however, the variability in all of this is much less, because it is a single business context: i.e. a hotel, where the responsibilities of the two contracting parties (i.e. owner and operator) are well defined.

The above discussion highlights that measures of interorganisational power are of limited applicability to the current study. It is possible to argue, however, that although owners and operators are separate and distinct organisations, certain factors arising in a hotel management contract signify that the intraorganisational power model (i.e. power within an organisation) can be applied to the current study. The reasons for this are explained in the following paragraphs.

As noted in the literature, a principal-agent relationship exists between the operator (principal) and the general manager (agent). In the majority of management contracts, the operator’s appointment of the general manager typically requires the approval of the owner (Eyster, 1997a; Guilding, 2003; Haast, et al., 2005). There is also evidence that hotel owners often pressurise operators to appoint general managers of the same nationality (Gannon & Johnson, 1997). The operator is typically responsible for directly employing the hotel’s general manager (Eyster, 1997b; Haast, et al., 2005). In some situations the owner pays for the general manager’s salary expenses immediately (Baker & McKenzie, 1996), while in other cases these expenses are initially paid for by the operator but are eventually reimbursed by the hotel owner (Eyster, 1997b; Guilding, 2003). The employment arrangement for the
general manager, however, can cause conflicts because, although the operator has primary control, the owner also wants to have some influence because they ultimately pay for the general manager’s salary.

It has also been noted that general managers typically have career patterns necessitating considerable mobility (Akrivos, et al., 2007; Ladkin & Riley, 1996; Riley & Ladkin, 1994), as they are typically transferred either within the same operating company (i.e. to higher levels) (Yeung, 2006) or to other operating companies (Swanljung, 1981). With this in mind, one could argue that general managers will be more likely to act in the operator’s interests as opposed to the owner’s interests to enhance their chances of gaining career promotions. On the other hand, an opposing argument can be formed due to the fact that owners typically select the general manager (see Eyster, 1997a; Guilding, 2003; Haast, et al., 2005). For this reason, general managers must be mindful to act in an owner’s interests when managing a hotel or be faced with the prospect of not being selected by owners for general manager positions in the future when their current employment contract expires or is terminated. In this situation, it could be argued, that general managers will be more likely to act in the owner’s interests as opposed to the operator’s interests to ensure future selection by owners for general manager positions. These two opposing arguments highlight that general managers are faced with incentives to act in both an owner’s and operator’s interests. The question therefore becomes, “In whose interests (i.e. the owner’s or the operator’s) will a general manager act?”

Adding insight into this important question, Guilding (2006, p. 403) noted that general managers are strategically placed “with respect to mediating the relationship between hotel owner and operator”, which suggests a relatively balanced approach between a general manager and their actions toward owners and operators. Guilding further (2006, p. 405) commented:

… in hotels governed by a management contract, general managers … are generally employees of the operating company. This signifies that they are in a highly significant position in terms of exposure to potential … tensions arising between the two contracting parties. As they work for the operator, the general managers … can be expected to hold goals that may have some inconsistency with the hotel owner’s goals. As it is the owner who finances the purchase of any hotel asset and assumes the ultimate risk associated with ownership (i.e. potential decline in the asset’s value), it is the owner who represents the party with ultimate sanctioning authority in any … decision. For this reason, the general manager … can be seen to be well placed to observe any ‘cross-fire’ between a hotel owner and operator.
Providing further insight suggesting that general managers may harbour a relatively balanced approach between the interests of owners and operators are the comments of GM1 provided during the interview phase of this study. GM1 commented:

I am a direct employee of the operator but I also have a dotted line to the owner that I am to act in their interests as well as the operator's interests ... if I started to make decisions that were owner biased then I would have the operator on my back. If I started to make decisions that were operator biased then I would have the owners on my back, so I have to be very careful to be fair to both parties.

Based on the view that a general manager is motivated to maintain a strong relationship with both owner and operator, it is argued that for the purposes of gauging power in the current study, a general manager’s relationship with both the owner and the operator can be viewed as being similar to a ‘within organisation’ relationship. This is because a hotel owner and operator are in an enduring organisational relationship. In light of this, the intraorganisational power literature appears most appropriate when considering the locus of power between hotel owners and operators.

With respect to the measurement of power within the intraorganisational power literature, Krause and Kearney (2006) note that empirical questionnaire based research has been conducted within the following organisational contexts: hospitals (see e.g. Raven, Schwarzwald, & Koslowsky, 1998); schools (see e.g. Koslowsky & Schwarzwald, 1993); orchestras (see e.g. Krause, Boerner, Lanwehr, & Nachtigall, 2002); and companies (see e.g. Blickle, et al., 1997; Buschmeier, 1995; Frost & Stahelski, 1988; Krause, 2004; Yukl & Falbe, 1991; Yukl, Kim, & Falbe, 1996). Within all of these contexts, the classical five power base typology developed by French and Raven (1959) has been used. This includes: (1) reward power; (2) coercive power; (3) legitimate power; (4) referent power; and (5) expert knowledge power (see e.g. Bachman, et al., 1966; Frost & Stahelski, 1988; Hinkin & Schriesheim, 1989; Martin & Hunt, 1980; Rahim, 1986; Schriesheim, Hinkin, & Podsakoff, 1991; Student, 1968). Also several studies have adapted this typology to measure power within organisations (see e.g. Ansari, 1990; Blickle, et al., 1997; Gierschner, 1991; Koslowsky & Schwarzwald, 1993; Krause, 2004; Krause, et al., 2002; Raven, et al., 1998; Thamhain & Gemmil, 1974; Yukl & Falbe, 1991). French and Raven (1960, pp. 612-613) describe their five bases of power in which an agent, O, can exert over a person, P, as follows:
(a) Reward power, based on P’s perception that O has the ability to mediate rewards for him; (b) coercive power, based on P’s perception that O has the ability to mediate punishments for him; (c) legitimate power, based on the perception by P that O has a legitimate right to prescribe behavior for him; (d) referent power, based on P’s identification with O; (e) expert power, based on the perception that O has some special knowledge or expertness.

In a review of the intraorganisational power literature, Krause and Kearney (2006) make a number of recommendations, which include that: (1) power bases be measured through the use of multi-item measurement; (2) that responses be rated rather than ranked; and (3) that future studies measure the wielding of power in its dependency on the particularities of the situation (i.e. context specific). In developing the current study’s measures for the locus of power between hotel owners and operators, Krause and Kearney’s (2006) recommendations have been heeded. This has resulted in three separate context specific questions posed for each of French and Raven’s (1959) five power bases using a seven-point Likert-type scale. Adaptations of this scale are necessary for the current study, however, because French and Raven (1959) measured power between superior and subordinate, which allowed for their Likert type scale to feature a full range of responses regarding this particular relationship. Within the current study, however, as explained earlier, the locus of power needs to be determined from two angles, which include firstly, between the general manager and the operator, and secondly, between the general manager and the owner. In this way, a relative locus of power between owner and operator can be determined. This has been achieved by employing a seven-point Likert scale with 1 being ‘the operator’, 4 being ‘both equally’, and 7 ‘the owner’. Prior to posing the questions, the following statement was given to the respondents: “In terms of your hotel owner and your hotel operating company, which entity is in a stronger position to:” The items following this question are overviewed in Table 11.6. Column one highlights French and Raven’s (1959) five power bases. Column two shows all the items comprising Question 30. Column three provides details of the source of the item. The fourth column provides the original question and the fifth column provides the adapted question used in the current study.
<table>
<thead>
<tr>
<th>French and Raven’s (1959) power base</th>
<th>Item sub-part</th>
<th>Author</th>
<th>Author’s original question</th>
<th>Current study’s question</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Reward Power</strong></td>
<td>a</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can increase my pay level?</td>
<td>Which entity is in a stronger position to provide you with increased pay?</td>
</tr>
<tr>
<td></td>
<td>f</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can influence my getting a promotion?</td>
<td>Which entity is in a stronger position to influence your next promotion?</td>
</tr>
<tr>
<td></td>
<td>k</td>
<td>Bachman, Smith and Slesinger (1966)</td>
<td>My supervisor can give special help and benefits to those who cooperate with him?</td>
<td>Which entity is in a stronger position to give you special help and benefits in return for your cooperation?</td>
</tr>
<tr>
<td><strong>Coercive power</strong></td>
<td>b</td>
<td>Bachman, Smith and Slesinger (1966)</td>
<td>My supervisor can apply pressure or penalize those who do not cooperate [with them]?</td>
<td>Which entity is in a stronger position to put pressure on you if they perceive you to not be supportive of their wishes?</td>
</tr>
<tr>
<td></td>
<td>g</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can make things unpleasant here?</td>
<td>Which entity is in a stronger position to make things unpleasant for you at the hotel?</td>
</tr>
<tr>
<td></td>
<td>l</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can make my work difficult for me?</td>
<td>Which entity is in a stronger position to make your work difficult?</td>
</tr>
<tr>
<td><strong>Legitimate power</strong></td>
<td>c</td>
<td>Bachman, Smith and Slesinger (1966)</td>
<td>My supervisor has a legitimate right, considering his position, to expect that his suggestions will be carried out?</td>
<td>Which entity is in a stronger position to require that their suggestions are carried out?</td>
</tr>
<tr>
<td></td>
<td>h</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can give me the feeling that I have responsibilities to fulfill?</td>
<td>Which entity in a stronger position to give you a sense of importance associated with fulfilling your responsibilities?</td>
</tr>
<tr>
<td></td>
<td>m</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can make me feel like I should satisfy my job requirements?</td>
<td>Which entity is in a stronger position to make you want to achieve a high level of performance?</td>
</tr>
<tr>
<td>Expert power</td>
<td>d</td>
<td>Yukl and Falbe (1991)</td>
<td>My supervisor has the experience and knowledge to earn my respect, and for me to defer to his/her judgment in some matters?</td>
<td>Which entity is in a stronger position to command your respect?</td>
</tr>
<tr>
<td>-------------</td>
<td>---</td>
<td>----------------------</td>
<td>----------------------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td></td>
<td>i</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can give me good technical suggestions?</td>
<td>Which entity is in a stronger position to provide you with good technical suggestions?</td>
</tr>
<tr>
<td></td>
<td>n</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can provide me with sound job-related advice?</td>
<td>Which entity is in a stronger position to provide you with sound job-related advice?</td>
</tr>
<tr>
<td>Referent power</td>
<td>e</td>
<td>Bachman, Smith and Slesinger (1966)</td>
<td>I admire my supervisor for his personal qualities, and want to act in a way that merits his respect and admiration?</td>
<td>Which entity is in a stronger position to expect you to act in order to win their respect and admiration?</td>
</tr>
<tr>
<td></td>
<td>j</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can make me feel valued?</td>
<td>Which entity is in a stronger position to make you feel valued?</td>
</tr>
<tr>
<td></td>
<td>o</td>
<td>Hinkin and Schriesheim (1989)</td>
<td>My supervisor can make me feel personally accepted?</td>
<td>Which entity is in a stronger position to provide you with a sense of being personally accepted?</td>
</tr>
</tbody>
</table>
In addition to posing the fifteen items comprising Question 30, it was also thought pertinent to pose a holistic question regarding the locus of power between hotel owners and operators. This was achieved in Question 31 by asking respondents: “In terms of influencing the hotel’s objectives/goals, which is more powerful?” A seven-point Likert-type scale was used with 1 being ‘the operator’, 4 being ‘both equally’, and 7 being ‘the owner’.

11.5 Conclusion

This chapter has discussed the questionnaire questions that have been used to measure the independent and dependent variables outlined in the propositions presented in the previous chapter. The questionnaire comprises thirty-three questions. Rationale for the posing of each of these questions has been given through a description of the link between the question and relevant theory. The next chapter provides details of the sampling frame, initial data screening, tests for non-response bias, and presents descriptive statistics for each of the questions posed in the questionnaire.
CHAPTER 12  
QUESTIONNAIRE ADMINISTRATION, DATA SCREENING AND DESCRIPTIVE STATISTICS

12.1 Introduction

This is the first of three chapters concerned with the collection and analysis of quantitative data. The chapter will describe the administration of the questionnaire survey, data screening, and descriptive statistics concerning each of the questions posed. Data analysed is in a raw form, i.e., prior to any consideration given to the application of data transformation procedures. The remainder of the chapter is organised as follows. The next section outlines the sampling procedures used and the response rate achieved. Following this, an outline of the data screening procedures undertaken prior to the calculation of descriptive statistics is presented. After this, a description of the steps taken in reviewing the data for non-response bias is presented. The penultimate section provides details of the descriptive information calculated in connection with each of the questions posed in the questionnaire. The final section provides a concluding commentary of the chapter.

12.2 Sampling procedures

The 2006/2007 RACQ Hotel Accommodation Guide provided the study’s sampling frame for Australian hotels. The sampling frame for the New Zealand (NZ) sample was drawn from cross checking against two comprehensive online databases, which included ‘wotif.com’ and ‘asiahotels.com’. All Australian and NZ hotels appearing in these directories with twenty rooms or more and a star-rating of three or more were included in the sample. Hotels not meeting these criteria were excluded as it was felt that such hotels would lack the facilities required to provide for complexity in dealing with asset related expenditure. This provided a total sample size of 664 hotels, comprising 463 hotels from Australia and 201 hotels from NZ. Mailed packages sent to each hotel contained a questionnaire (see appendix G), a covering letter (see appendix F), a colour flyer printed on high quality glossy paper indicating endorsement of the study by three leading hotel consultancy companies (see appendix A), a further flyer also printed on high quality glossy paper, that provided a photograph of the researchers and brief research biographies, and a reply paid envelope. Surveys sent to 10 Australian hotels and 9 NZ hotels were returned marked “return to sender”. Additionally, 7
responses (4 from Australia and 3 from NZ) were received where the questionnaire was not completed but a note was attached indicating that it was against company policy to complete questionnaires.

Three weeks after the first mailing, a second mailout (see appendix I) was sent to the entire sampling frame (less those marked ‘return to sender’ and ‘against company policy’ from the first mailing) to encourage non-respondents to complete the questionnaire (M. Smith, 2003).¹ Five responses (2 from Australia and 3 from NZ) to this second mailout were not completed but had a note indicating that it was against company policy to complete questionnaires. The number of letters marked ‘return to sender’ and ‘against company policy to complete questionnaires’ from the first and second mailings signify a reduction in the initial sampling frame of 664 hotels to 633. Two weeks after the second mailout, a number of hotel owner representatives that had been interviewed during the earlier empirical phase were contacted as they had indicated a willingness to assist in distributing the questionnaire to GMs with whom they had contact. Two weeks following the owner representatives’ distribution of the questionnaires, the sample was contacted by email with the survey provided in Microsoft Word format. In this email, respondents that had not already responded to the earlier mailings were encouraged to respond. Finally, two weeks after the sample was contacted by email, random telephone calls were made to 31 GMs. The objective of these phone calls was threefold:

1. To thank the GM if they had already completed the survey;
2. If the GM had not completed the survey, to ascertain why the survey had not been completed (as part of a test for non-response bias); and
3. To encourage the respondent to respond.

Eleven of the phone calls were to GM’s that had already completed the questionnaire. Of the remaining 20 phone calls to non-respondents, a variety of reasons were given for non-response. Of the 20 non-respondents contacted via telephone, 12 (10 from Australia and 2 from NZ) indicated that they did not want to participate as it was against company policy (these 12 responses were taken to further reduce the sampling frame from 633 to 621), the other 8 respondents contacted by telephone indicated that they would seek to complete it. The response pattern is outlined in Table 12.1.

¹ The entire sampling frame was sent the second mailout as full anonymity of responses was considered important in order to elicit a high response rate.
TABLE 12.1
Summary of survey replies

<table>
<thead>
<tr>
<th>Country</th>
<th>Australia (n)</th>
<th>New Zealand (n)</th>
<th>Total (n)</th>
<th>Response rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>First mailing</td>
<td>55</td>
<td>28</td>
<td>83</td>
<td>13.37%</td>
</tr>
<tr>
<td>Second mailing</td>
<td>36</td>
<td>11</td>
<td>47</td>
<td>7.57%</td>
</tr>
<tr>
<td>Industry distribution</td>
<td>41</td>
<td>10</td>
<td>51</td>
<td>8.21%</td>
</tr>
<tr>
<td>Emailing</td>
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<td>6</td>
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<td>2.58%</td>
</tr>
<tr>
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<td>0.48%</td>
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<tr>
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</tr>
<tr>
<td>Total number in sample</td>
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<td>184</td>
<td>621</td>
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<tr>
<td>Total response rate</td>
<td></td>
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<td>32.21%</td>
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</table>

12.3 Questionnaire data screening

This section describes data screening procedures undertaken prior to the calculation of the descriptive statistics. Sub-sections describe steps taken in connection with the following issues: data input accuracy; out-of-range values; plausible means and standard deviations; univariate outliers; missing data; and normality.

12.3.1 Data input accuracy

According to Tachachnik and Fidell (2007), the first stage of data screening involves ensuring data input accuracy. Consistent with this recommendation, the computerised data file was compared with the original data coded on the returned questionnaires. Minimal error was detected and rectified.

12.3.2 Out-of-range values

Data for each variable was systematically sorted into ascending order within the computerised data file and checked for any out-of-range values. One figure that had been inputted as ‘66’ instead of ‘6’ was identified and corrected through this process.
12.3.3 Plausible means and standard deviations

Means and standard deviations were computed for all variables. Although some relatively high standard deviations were observed on the following four variables: (1) question 4a ‘hotel age’ (std. dev. 23.50 years); (2) question 6a ‘hotel size in number of rooms’ (std. dev. 117.23 rooms); (3) question 7a ‘hotel owner size in terms of number of hotels owned’ (std. dev. 1,021.86 hotels); and (4) question 7b ‘hotel owner size in terms of number of hotel rooms owned’ (std. dev. 70,143.12 rooms), such values are to be expected given the nature of these variables. All variables were seen as having plausible means and standard deviations.

12.3.4 Univariate outliers

Univariate outliers are cases that have a highly extreme value on one variable that can distort statistics (Tabachnick & Fidell, 2007). In order to test for the presence of univariate outliers, Tabachnick and Fidell (2007) suggest the computation of standardised z-scores. For continuous variables, potential univariate outliers are cases with standardised z-scores of ±3.29 ($\rho < .001$, two-tailed test). Within large samples, Tabachnick and Fidell (2007) note that a few standardised z-scores in excess of (or less than) 3.29 are to be expected. Following Tabachnick and Fidell’s (2007) guidelines, univariate outliers were detected for the following variables:

- Hotel age (question 4a), 5 univariate outliers detected as follows: 102 years old ($z = 3.35$), 110 years old ($z = 3.70$), 118 years old ($z = 4.04$), 125 years old ($z = 4.33$), and 128 years old ($z = 4.46$).
- Number of years GM (question 4b), 4 univariate outliers detected as follows: 18 years ($z = 3.39$), 20 years ($z = 3.87$), 20 years ($z = 3.87$), 26 years ($z = 5.32$).
- Hotel size in number of rooms (question 6a), 1 univariate outlier was detected as follows: 600 rooms ($z = 3.61$).
- Hotel size in terms of annual sales turnover (question 6b), 3 univariate outliers were detected as follows: $60$ million ($z = 3.68$), $60$ million ($z = 3.68$), $80$ million ($z = 5.25$).
- Hotel owner size in terms of number of hotels owned (question 7a), 10 univariate outliers were detected as follows: 3 outliers with a value of 3,900 hotels ($z = 3.50$), and 7 outliers with a value of 4,000 hotels ($z = 3.60$).
Owner size in terms of number of rooms owned (question 7b), 6 univariate outliers were detected as follows: 270,000 rooms ($z = 3.57$), 275,000 rooms ($z = 3.64$), 280,000 rooms ($z = 3.71$), 350,000 rooms ($z = 4.71$), 390,000 rooms ($z = 5.28$), 400,000 rooms ($z = 5.43$).

In all of the above cases where univariate outliers were detected, it was determined that the outliers had not resulted from incorrect data entry. Also, the outliers were not viewed as falling into a population that was not intended to be sampled. As a result, the noted outliers were not deleted (Tabachnick & Fidell, 2007). According to Tabachnick and Fidell (2007), where univariate outliers are deemed to be from the intended population but the distribution for the variable in the population has more extreme values than a normal distribution, consideration can be given toward changing the value on the variable (i.e. through transformation or score alteration so that it no longer has as much impact). Inspection of histograms in consultation with a resident expert statistician from Griffith University has suggested normality in all distributions, however. While consideration was given to modifying the values of the univariate outliers detected, it was preferred to make no modifications in the data; as such modification could give rise to a potential “data tampering” criticism.

12.3.5 Missing data

Tabachnick and Fidell (2007) explain that one of the most pervasive problems in data analysis is missing data. Much of the reason for this is that many of today’s analytical procedures were not designed to accommodate variables with missing data (Schafer & Graham, 2002). The seriousness of the problem of missing data, depends on the pattern of the missing data, how much data is missing and why the data is missing (Tabachnick & Fidell, 2007). The pattern of missing data, however, is generally more important than the amount missing. If missing values are randomly distributed throughout a data matrix, no problem is posed provided the number of missing cases does not exceed 5% in a large data set (where a large data set is regarded as containing more than 100 cases) (Tabachnick & Fidell, 2007). For variables containing missing data in this study, an inspection of the pattern of missing data was carried out. In all cases, missing data was found to be randomly distributed throughout the data matrix. The variables with more than 5% missing data are identified below:
- Owner size in terms of number of hotels owned (question 7a): 8.5%
- Owner size in terms of number of hotel rooms owned (question 7b): 15.5%
- Management contract length (question 21): 15.8%
- Remaining length of management contract (question 22): 15.8%
- Actual allocation to the FF&E reserve (question 24): 8.0%
- True cost of FF&E (question 26): 14.8%

Methods used to handle missing values are wide ranging. Tabachnick and Fidell (2007) explain that cases with missing data can simply be dropped. This approach is generally used where there are only a few cases that have missing data and these appear to be a random sub-sample of the whole sample. A second approach is to input estimates of the missing values. Common approaches that can be taken in data estimation are: use prior knowledge, mean substitution, regression, expectation maximisation or multiple imputation. A third approach is to use a missing data correlation matrix. A fourth method is to treat missing data as data. Finally, missing values can be ignored but the analysis run with and without the cases with missing data to ensure that the result is similar. On this final point, as explained by Tabachnick and Fidell (2007), provided that the sample size is large (i.e. greater than 100 cases) and that the data are not missing in a non-random pattern, the analyses does not need to be run without cases with missing data. In keeping with the philosophy of minimising modification of data, missing data for the above variables was therefore ignored.

12.3.6 Normality

Tabachnick and Fidell (2007) explain that normality is assessed by either statistical or graphical methods. A normal distribution will be symmetrical with fifty per cent of the scores on one side of the mean, and fifty per cent on the other side of the mean (Berenson, Levine, & Krehbiel, 2002). Two dimensions of normality are skewness and kurtosis. Skewness is concerned with the symmetry of the distribution of data whereby a skewed variable would have a mean that is not in the centre of the distribution. Kurtosis relates to the spread of scores and peakedness in a distribution (Tabachnick & Fidell, 2007). Positive kurtosis typically has little effect on inferential analysis, particularly in sample sizes greater than 200, while the severity of negative kurtosis is reduced where sample sizes are greater than 100 (Berenson, et al., 2002).
With regard to the issue of assessing normality via either statistical or graphical methods, for sample sizes exceeding 100, Tabachnick and Fidell (2007) recommend viewing the shape of the distribution rather than using statistical inference tests, such as the Kolmogorov-Smirnov or Shapiro-Wilk measure, because the standard errors for both skewness and kurtosis decrease with larger sample sizes. This implies that these statistical inference tests may become too conservative as sample sizes increase and there will be a rejection of the null hypothesis with even very small deviations from normality (Coakes & Steed, 2006).

In line with the recommendations of Tabachnick and Fidell (2007) and Coakes and Steed (2006), normality of the distribution of variables was assessed using graphical techniques. This included visual inspection of frequency distributions, stem and leaf plots, histograms, box plots, normal probability Q-Q plots and detrended plots. To ensure a rigorous analysis, a resident expert statistician from Griffith University was consulted. This expert concluded that all the variables could be treated as normal.

12.4 Nonresponse bias investigation

Three investigations for non-response bias were undertaken. Firstly, as noted earlier, 20 non-respondents were contacted by telephone. A variety of reasons were given for the non-response. The most common reason given was that “it was against company policy to fill out questionnaires”. Another common reason was that the GM was “too busy” and that “the GM had been on holidays and didn’t recall having received the questionnaire”. None of these reasons gives rise to any degree of concern regarding a potential for non-response bias.

A second appraisal of non-response bias was undertaken by comparing the sample data with the population data based upon hotel star-rating. Population data for Australian hotels was derived from the 2006/2007 RACQ Hotel Accommodation Guide while NZ hotel population data was drawn from a cross check against two comprehensive online databases, which included ‘wotif.com’ and ‘asiahotels.com’. The Australian and NZ directories provided information regarding hotel size in terms of number of rooms as well as star-rating.

A comparison of the sample data with the population data based upon hotel star-rating is shown in Table 12.2. Within the Table, information is provided in connection with the
Australian sample, the New Zealand sample, and combined totals from the Australian and New Zealand samples. In each of these sections, a breakdown is made based on hotel size in terms of number of rooms, with small sized hotels categorised as those ranging from 20 to 105 rooms, medium sized hotels 106 rooms to 200 rooms and large sized hotels being more than 201 rooms. This breakdown was made so that approximately one-third of the sample responses were assigned to each group. Acknowledging that statistical significance tests have not been undertaken, the Table shows that the mean star-rating of the sample (4.17) is higher than the mean star-rating of the population (4.04). The mean star-rating of the Australian sample (4.28) is also higher than the mean star-rating of the Australian population (4.10). On the other hand, the mean star-rating of the New Zealand sample (3.88) is marginally lower than the mean star rating of the New Zealand population (3.91). It is concluded from this analysis that the survey sample is reasonably closely representative of the population.
<table>
<thead>
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<th>Sample Sml</th>
<th>Med</th>
<th>Lge</th>
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<td>79</td>
<td>54%</td>
<td><strong>201</strong></td>
</tr>
</tbody>
</table>

The third test for non-response bias involved an investigation for systematic differences between the first mailing respondents (group 1) and the reminder of the respondents (group
2). To test for differences in categorical variables, a non-parametric Chi-square test for independence was used. No statistically significant differences were found.\(^3\) To test for non-response bias in the ordinal variables measured using Likert scales, a Mann-Whitney U Test was used. With sample sizes in excess of 100 (see Stevens, 1996), very small differences between groups can become statistically significant when using a Mann-Whitney U Test (Pallant, 2007). As a result, although the result of a test for a particular variable may be significant, this should be interpreted with care. To assess the importance of a significant finding, it is necessary to calculate the “effect size”, which is known as “strength of association” (Pallant, 2007, p. 207). When using the Mann-Whitney U Test, strength of association is calculated using an \(r\) value (Cohen, 1988). The following criteria apply to the \(r\) value: 0.1 = small effect; 0.3 = medium effect; and 0.5 = large effect (Cohen, 1988).\(^4\) Mann-Whitney U tests revealed significant differences (at \(p < .05\)) between the respondents to the first mailing (group 1) and the other respondents (group 2) on the following variables:

- **Question 8c**, which was the first of three questions concerned with determining the importance of strategic factors in capital budgeting decision making: Group 1 (\(Md = 5, n = 83\)), Group 2 (\(Md = 5, n = 116\)), \(U = 3846.00, z = -2.477, \rho = 0.013, r = 0.18\) (small effect).

- **Question 8f**, which was the first of three questions concerned with determining the importance of intuition in capital budgeting decision making: Group 1 (\(Md = 5, n = 83\)), Group 2 (\(Md = 4, n = 116\)), \(U = 3995.50, z = -2.085, \rho = 0.037, r = 0.15\) (small effect).

- **Question 8g**, which was the second of three questions concerned with determining the importance of intuition in capital budgeting decision making: Group 1 (\(Md = 4, n = 82\)), Group 2 (\(Md = 4, n = 115\)), \(U = 3915.50, z = -2.060, \rho = 0.039, r = 0.15\) (small effect).

- **Question 8k**, which was the third of three questions concerned with the importance of intuition in capital budgeting decision making: Group 1 (\(Md = 6, n = 83\)), Group 2 (\(Md = 5, n = 117\)), \(U = 3851.00, z = -2.563, \rho = 0.010, r = 0.18\) (small effect).

\(^2\) It was considered pertinent to combine the responses from the second mailing, industry distribution, emailing, and telephone contact into one group as such respondents were all seen as being slower to respond than the respondents to the first mailing.

\(^3\) Categorical variables included: (1) star-rating (Question 1); hotel operating structure (Question 2); (3) public vs. private hotel ownership (Question 5); and (4) type of FF&E reserve (Question 23).

\(^4\) \(r\) values are not able to be calculated in SPSS. They can, however, be calculated as: \(r = z / \sqrt{N}\) (where \(N = \text{total number of cases}\)) (Pallant, 2007).
Question 14, which was the second of three questions concerned with ego-trip ownership: Group 1 \((Md = 3, n = 82)\), Group 2 \((Md = 2, n = 116)\), \(U = 3674.00, z = -2.808, \rho = 0.005, r = 0.20\) (small effect).

Question 16, which was the first of four questions concerned with determining the degree of owner involvement in the capital budgeting process: Group 1 \((Md = 6, n = 82)\), Group 2 \((Md = 6, n = 116)\), \(U = 3912.50, z = -2.294, \rho = 0.022, r = 0.16\) (small effect).

Question 30g, which was the second of three questions concerned with coercive power: Group 1 \((Md = 4, n = 36)\), Group 2 \((Md = 4, n = 61)\), \(U = 834.50, z = -2.223, \rho = 0.026, r = 0.23\) (small effect).

This analysis indicates that in all cases, although some significant differences were noted from the Mann-Whitney \(U\) test, the strength of association between the two groups \((r\) value) was small. As a result, although a degree of concern may be expressed with regard to the possibility of non-response bias, the effect appears to be small.

To test the non-scaled continuous (ratio level) variables for non-response bias, an independent samples t-test was used. When using such a test, it is important to note that while a ‘statistically significant’ difference may exist between groups, it does not show the degree to which the two variables are associated with one another (Pallant, 2007). To determine the strength of association when using the independent samples t-test, the most commonly used statistic is ‘eta squared’ (Pallant, 2007).\(^5\) Eta squared can range from 0 to 1 and represents the proportion of variance in the variable under observation (dependent variable) that is explained by the grouping variable (independent variable) (Pallant, 2007). The guidelines proposed by Cohen (1988, pp. 284-287) for interpreting the value of ‘eta squared’ are: \(0.01 = \) small effect, \(0.06 = \) moderate effect, \(0.14 = \) large effect.

Independent samples t-tests indicated that there was a significant difference between respondents to the first mailing (group 1) and the other respondents (group 2) on the following variable:

- Number of years the GM has been in that position at the hotel (Question 4b): Group 1 \((M = 4.90, SD = 4.33)\), Group 2 \((M = 3.20, SD = 3.90)\); \(t (191) = 2.810, \rho = 0.006\)

\(^5\) SPSS does not calculate eta squared. The formula for eta squared is as follows: \(\frac{t^2}{t^2 + (\text{number of observations in group 1} + \text{number of observations in group 2} - 2)}\) (Pallant, 2007, p. 236).
(two-tailed). The magnitude of the differences in the means (mean difference = 1.71, 95% CI: 0.53 to 2.88) was small (eta squared = 0.04).

The results of the independent samples t-tests indicate that although a degree of concern may be expressed with regard to a potential for non-response bias, the effect of such non-response bias is small.

12.5 Descriptive statistics

This section provides descriptive information based on the entire sample for each of the questions posed in the questionnaire. For each question, the data is analysed according to the Australian and NZ sub-samples as well as the data for the entire sample. In the descriptive analysis presented, no tests for statistical significance between the two countries examined (Australia and NZ) have been undertaken. This is because the study has not sought to pursue this line of analysis. Nevertheless, brief comment is provided on some relative differences between the data collected in the two countries. To take such a line of enquiry further, tests for statistically significant differences would have to be prepared. With this in mind, minimal difference was observed between the descriptive statistics concerning Australian and New Zealand hotels. Within each of the sub-groups, an additional breakdown is made based on hotel size (number of rooms). In order to categorise descriptive information by hotel size, the sample was split at the 33rd and 66th percentiles to provide three groups: small, medium and large hotels. Small hotels range between 20 and 105 rooms, medium hotels range between 106 and 200 rooms, and large sized hotels exceed 201 rooms.

12.5.1 Star-rating (Question 1)

Question 1 asked “What is the star-rating of your hotel?” Table 12.3 shows that the mean star-rating of the total sample is 4.17. Australian hotels had a higher mean star rating (4.28) than NZ hotels (3.88). The total sample shows that small hotels (3.98) tend to have a lower star-rating than medium sized hotels (4.08) and large hotels (4.43).
### Table 12.3

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>3 Star</td>
<td>0.0%</td>
<td>3.7%</td>
<td>0.0%</td>
</tr>
<tr>
<td>3.5 Star</td>
<td>18.8%</td>
<td>13.0%</td>
<td>3.4%</td>
</tr>
<tr>
<td>4 Star</td>
<td>50.0%</td>
<td>40.7%</td>
<td>22.4%</td>
</tr>
<tr>
<td>4.5 Star</td>
<td>28.1%</td>
<td>38.9%</td>
<td>39.7%</td>
</tr>
<tr>
<td>5 Star</td>
<td>3%</td>
<td>3%</td>
<td>34.5%</td>
</tr>
<tr>
<td>n</td>
<td>32</td>
<td>54</td>
<td>58</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Mean</th>
<th>Sd. dev.</th>
<th>n</th>
<th></th>
<th>Mean</th>
<th>Sd. dev.</th>
<th>n</th>
<th></th>
<th>Mean</th>
<th>Sd. dev.</th>
<th>n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sml</td>
<td>4.08</td>
<td>0.38</td>
<td>32</td>
<td></td>
<td>4.13</td>
<td>0.44</td>
<td>54</td>
<td></td>
<td>4.53</td>
<td>0.42</td>
<td>58</td>
</tr>
<tr>
<td>Med</td>
<td>4.46</td>
<td>0.46</td>
<td>32</td>
<td></td>
<td>4.53</td>
<td>0.46</td>
<td>54</td>
<td></td>
<td>4.53</td>
<td>0.46</td>
<td>58</td>
</tr>
<tr>
<td>Lge</td>
<td>4.28</td>
<td>0.46</td>
<td>32</td>
<td></td>
<td>3.89</td>
<td>0.77</td>
<td>31</td>
<td></td>
<td>3.86</td>
<td>0.66</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>3.88</td>
<td>0.71</td>
<td>32</td>
<td></td>
<td>3.88</td>
<td>0.71</td>
<td>54</td>
<td></td>
<td>3.88</td>
<td>0.71</td>
<td>58</td>
</tr>
<tr>
<td></td>
<td>195</td>
<td></td>
<td></td>
<td></td>
<td>195</td>
<td></td>
<td></td>
<td></td>
<td>195</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### 12.5.2 Hotel operating structure (question 2)

Question 2 asked the respondent to indicate whether their hotel operated under a management contract, a franchise, as an independent owner-operator, or some other hotel ownership / management structure. Table 12.4 shows that for the total sample, 50.5% of hotels operate with a management contract, 37.0% are owner-operated, 9.0% are franchised, and 3.5% adopt some other form of hotel ownership / management structure. Of these “other” responses, in all cases a leasing arrangement was adopted. Greater use of management contracts was made by Australian hotels (58.6%) compared to NZ hotels (29.1%). On the other hand, NZ hotels had a higher proportion of owner-operators (60.0%) than Australian hotels (28.3%). Use of the franchise arrangement appears relatively consistent across Australian (9.7%) and NZ hotels (7.3%).

### Table 12.4

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>Management contract</td>
<td>39.4</td>
<td>61.1</td>
<td>67.2</td>
</tr>
<tr>
<td>Franchise</td>
<td>12.1</td>
<td>11.1</td>
<td>6.9</td>
</tr>
<tr>
<td>Independent owner-operator</td>
<td>45.5</td>
<td>24.1</td>
<td>22.4</td>
</tr>
<tr>
<td>Other</td>
<td>3.0</td>
<td>3.7</td>
<td>3.4</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
<td>54</td>
<td>58</td>
</tr>
</tbody>
</table>
12.5.3 Hotel age (question 4a)

Question 4a asked the respondent “Approximately how many years old is your hotel?”. Table 12.5 shows that the mean hotel age for the total sample was 23.17 years. Australian hotels had a higher mean age (23.52 years) than NZ hotels (22.24 years). Small hotels had a higher mean age (27.90 years) than medium (21.99 years) and large hotels (19.56 years).

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>Years old</td>
<td>32.30</td>
<td>22.75</td>
<td>19.14</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>32.73</td>
<td>17.86</td>
<td>18.80</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
<td>51</td>
<td>57</td>
</tr>
</tbody>
</table>

12.5.4 Years GM (question 4b)

Question 4b asked the respondent “approximately how many years have you been GM at this property?”. Table 12.6 shows that on average GMs had been in their current position for 3.90 years. GMs in small hotels had been in their current position for a lesser period of time (3.96 years) than GMs in large hotels (4.38 years). GMs in Australian hotels had held their current position for a lesser period of time (3.84 years) than GMs in NZ hotels (4.07 years).

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>No. of years</td>
<td>4.01</td>
<td>3.17</td>
<td>4.33</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>5.63</td>
<td>2.48</td>
<td>4.59</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
<td>50</td>
<td>56</td>
</tr>
</tbody>
</table>

12.5.5 Public vs. private hotel ownership (question 5)

Question 5 asked respondents to indicate whether their hotel owner’s entity was public or private. Table 12.7 shows that private ownership dominated for the total sample (70.9%).
Small hotels have more private ownership (80.3%) than large hotels (61.5%). Australian hotels have a lower tendency toward private ownership (65.2%) than NZ hotels (85.5%).

<table>
<thead>
<tr>
<th>TABLE 12.7</th>
<th>Hotel owner’s entity (question 5)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Australia</td>
</tr>
<tr>
<td></td>
<td>Sml %</td>
</tr>
<tr>
<td>Public</td>
<td></td>
</tr>
<tr>
<td></td>
<td>34.4</td>
</tr>
<tr>
<td>Private</td>
<td></td>
</tr>
<tr>
<td></td>
<td>65.6</td>
</tr>
<tr>
<td>n</td>
<td>32</td>
</tr>
</tbody>
</table>

12.5.6 Hotel size in number of rooms (question 6a)

Question 6a asked the respondents to indicate the approximate size of their hotel in terms of number of rooms. Table 12.8 shows that for the total sample the mean number of rooms was 176.61. Australian hotels had a higher mean number of rooms (203.60) than NZ hotels (105.44).

<table>
<thead>
<tr>
<th>TABLE 12.8</th>
<th>Hotel size in number of rooms (question 6a)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Australia</td>
</tr>
<tr>
<td>Mean number of rooms</td>
<td>203.60</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>117.91</td>
</tr>
<tr>
<td>n</td>
<td>145</td>
</tr>
</tbody>
</table>

12.5.7 Hotel size in AUD$ turnover (question 6b)

Question 6b asked the respondents to indicate the approximate size of their hotel in annual sales turnover (AUD$). Table 12.9 shows that for the total sample, the average turnover was $AUD12.98 million. Australian hotels had a higher average turnover ($16.06 million) than NZ hotels ($4.47 million). Unsurprisingly, small hotels ($3.40 million) had a lower turnover than medium ($9.75 million) and large hotels ($25.11 million).
### Table 12.9

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>Turnover $AUD (million)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>4.85</td>
<td>10.22</td>
<td>27.48</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>2.48</td>
<td>4.37</td>
<td>14.07</td>
</tr>
<tr>
<td>n</td>
<td>30</td>
<td>54</td>
<td>57</td>
</tr>
</tbody>
</table>

12.5.8 Hotel owner size in terms of number of hotel properties owned (question 7a)

Question 7a asked respondents to indicate their hotel owner’s approximate size in terms of the number of hotel properties owned. Table 12.10 shows that for the total sample, the average number of hotel properties owned was 323. NZ hotel owners owned a higher mean number of hotel properties (395) than Australian hotel owners (296).

### Table 12.10

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>Hotels owned</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>385</td>
<td>384</td>
<td>172</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1133</td>
<td>1067</td>
<td>735</td>
</tr>
<tr>
<td>n</td>
<td>29</td>
<td>49</td>
<td>55</td>
</tr>
</tbody>
</table>

12.5.9 Hotel owner size in terms of number of hotel rooms owned (question 7b)

Question 7b asked respondents to indicate their hotel owner’s approximate size in terms of the number of hotel rooms owned. Table 12.11 shows that for the total sample, the average number of hotel rooms owned was 19,361. Owners of NZ hotels owned a higher mean number of hotel rooms (19,530) than Australian hotel owners (19,294).

### Table 12.11

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>Rooms owned</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>9346</td>
<td>34349</td>
<td>10949</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>42164</td>
<td>95528</td>
<td>46575</td>
</tr>
<tr>
<td>n</td>
<td>27</td>
<td>45</td>
<td>49</td>
</tr>
</tbody>
</table>

215
12.5.10 Factors influencing whether an investment proposal is approved (question 8)

Question 8 asked respondents to indicate the extent to which 12 factors influence whether an investment proposal is approved. These 12 questions related to 4 themes as follows: (1) financial analysis (questions 8a, 8j, 8l); (2) strategic analysis (questions 8b, 8c, 8i); internal political factors (question 8e, 8g, 8h); and managerial intuition (question 8d, 8f, 8k). The sections below analyse the descriptive information associated with each of these themes. For all questions posed, a seven-point Likert scale was used with 1 being ‘not at all’ and 7 being ‘to a large extent’.

12.5.10.1 Financial analysis (questions 8a, 8j, 8l)

Table 12.1 provides descriptive information regarding the extent to which factors associated with “financial analysis” (questions 8a, 8j, 8l) influence whether an investment proposal is approved. Question 8a was concerned with whether a proposal is justifiable on financial grounds. Table 12.1 shows that for the total sample, this factor is important with a mean response of 6.08. Respondents from Australian hotels considered this factor more important (6.13) than NZ respondents (5.95). For the total sample, small hotels saw this factor as less important (5.88) than respondents of medium sized hotels (6.17) and large hotels (6.19).

Question 8j concerns the extent that cash flow and profitability forecasts supporting a proposal’s viability influences investment proposal approval. Table 12.1 shows that for the total sample, this factor is important with a mean response of 5.86. Respondents from Australian hotels considered the factor more important (5.87) than NZ respondents (5.83). For the total sample, small hotels considered this factor less important (5.65) than respondents of medium sized hotels (5.91) and large hotels (6.01).

Question 8l concerns whether the extent to which a project’s budget provides a good financial return affects the decision to approve the investment proposal. Table 12.1 shows that for the total sample, this factor is important with a mean response of 5.91. Australian respondents see this factor as more important (5.99) than NZ respondents (5.69). For the total sample, small hotels considered this factor less important (5.66) than large hotel respondents (5.96).
Table 12.1 provides descriptive information concerning the extent to which strategic factors affect whether an investment proposal is supported (questions 8b, 8c, 8i). Question 8b was concerned with determining whether a proposal can be justified on the basis of gaining marketplace competitive advantage. Table 12.1 shows that for the total sample, this factor is important with a mean response of 5.32. Respondents from NZ hotels considered this factor more important (5.40), than Australian respondents (5.29).

Question 8c was concerned with whether a proposal is justified by a thoroughly conducted strategic analysis (e.g. competitive positioning analysis, SWOT analysis). Table 12.13 shows that for the total sample this factor is important with a mean response of 4.99. Australian respondents considered this factor more important (5.04) than NZ respondents (4.85).

Question 8i was concerned with whether a project represents an opportunity to pre-empt the competition. Table 12.13 shows that for the total sample, this factor is important with a mean response of 4.64. Respondents from NZ hotels considered this factor more important (4.67) than Australian respondents (4.63).
### TABLE 12.13
Strategic analysis (questions 8b, 8c, 8i)

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td><strong>8b</strong> The proposal can be justified on the basis of gaining marketplace competitive advantage? (Scale: 1 = not at all, 7 = to a large extent)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Score</strong></td>
<td>5.30</td>
<td>5.19</td>
<td>5.38</td>
</tr>
<tr>
<td><strong>Std. dev.</strong></td>
<td>1.26</td>
<td>1.29</td>
<td>1.17</td>
</tr>
<tr>
<td><strong>n</strong></td>
<td>33</td>
<td>54</td>
<td>58</td>
</tr>
<tr>
<td><strong>8c</strong> The proposal is justified by a thoroughly conducted strategic analysis (e.g. competitive positioning analysis, SWOT analysis)? (Scale: 1 = not at all, 7 = to a large extent)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Score</strong></td>
<td>5.06</td>
<td>4.80</td>
<td>5.26</td>
</tr>
<tr>
<td><strong>Std. dev.</strong></td>
<td>1.39</td>
<td>1.50</td>
<td>1.51</td>
</tr>
<tr>
<td><strong>n</strong></td>
<td>32</td>
<td>54</td>
<td>58</td>
</tr>
<tr>
<td><strong>8i</strong> The project represents an opportunity to pre-empt the competition? (Scale: 1 = not at all, 7 = to a large extent)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Score</strong></td>
<td>4.88</td>
<td>4.57</td>
<td>4.53</td>
</tr>
<tr>
<td><strong>Std. dev.</strong></td>
<td>1.50</td>
<td>1.41</td>
<td>1.48</td>
</tr>
<tr>
<td><strong>n</strong></td>
<td>32</td>
<td>54</td>
<td>58</td>
</tr>
</tbody>
</table>

### 12.5.10.3 Internal political factors (questions 8e, 8g, 8h)

Table 12.14 provides descriptive information regarding the extent to which factors associated with “internal political factors” (questions 8e, 8g, 8h) influence whether an investment proposal is supported. Question 8e concerns determining whether a proposal’s main sponsor’s company track record influences proposal acceptance. Table 12.14 shows that for the total sample, this factor is fairly important with a mean response of 4.16. Small hotels considered this factor more important (4.51) than medium sized hotels (4.00) and large hotels (3.96). Respondents from NZ hotels considered this factor more important (4.29) than Australian respondents (4.10).

Question 8g was concerned with determining whether the shrewd negotiating capacity of a project’s sponsor affects the likely acceptance of an investment proposal. Table 12.14 shows that for the total sample, this factor is slightly unimportant with a mean response of 3.70. Small hotels considered this factor more important (4.14) than medium sized hotels (3.72) and large hotels (3.24). Respondents from NZ hotels considered this factor more important (3.87) than respondents of Australian hotels (3.63).

Question 8h was concerned with the extent that the sponsoring manager’s understanding of internal politics affects the likely acceptance of an investment proposal. Table 12.14 shows
that for the total sample this factor is slightly unimportant with a mean response of 3.55. Small hotels considered this factor more important (3.82) than medium sized hotels (3.68) and large hotels (3.16). Respondents from NZ hotels considered this factor more important (3.85) than respondents of Australian hotels (3.44).

### TABLE 12.14

<table>
<thead>
<tr>
<th>Internal political factors (questions 8e, 8g, 8h)</th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td><strong>8e)</strong> The proposal’s main sponsor (i.e. the manager most closely associated with the project’s initiation and development) has a strong company track record? (Scale: 1 = not at all, 7 = to a large extent)</td>
<td>Score</td>
<td>4.33</td>
<td>4.02</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.49</td>
<td>1.71</td>
<td>1.92</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
<td>54</td>
<td>58</td>
</tr>
<tr>
<td><strong>8g)</strong> The manager acting as the proposal’s sponsor is a shrewd negotiator? (Scale: 1 = not at all, 7 = to a large extent)</td>
<td>Score</td>
<td>3.97</td>
<td>3.81</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.19</td>
<td>1.70</td>
<td>1.70</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
<td>52</td>
<td>58</td>
</tr>
<tr>
<td><strong>8h)</strong> The manager acting as the proposal’s sponsor understands internal politics and uses this to advantage in seeking company approval? (Scale: 1 = not at all, 7 = to a large extent)</td>
<td>Score</td>
<td>3.61</td>
<td>3.67</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.62</td>
<td>2.00</td>
<td>1.75</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
<td>54</td>
<td>58</td>
</tr>
</tbody>
</table>

### 12.5.10.4 Managerial intuition (questions 8d, 8f, 8k)

Table 12.15 provides descriptive information regarding the extent to which factors associated with “managerial intuition” (questions 8d, 8f, 8k) influence whether an investment proposal is approved. Question 8d was concerned with determining the extent that a proposal’s merit on intuitive grounds affects its likely acceptance. Table 12.15 shows that for the total sample this factor is unimportant with a mean response of 3.20. Small hotels considered this factor more important (3.45) than medium sized hotels (3.18) and large hotels (2.97). Respondents from NZ hotels considered this factor more important (3.48) than respondents of Australian hotels (3.10).

Question 8f was concerned with determining whether experience suggesting that a project will be successful influences the proposal’s acceptability. Table 12.15 shows that for the total sample this factor is slightly important with a mean response of 4.42. Small hotels considered
this factor more important (5.02) than medium sized hotels (4.26) and large hotels (4.00). Respondents from NZ hotels considered this factor more important (4.69) than respondents of Australian hotels (4.32).

Question 8k was concerned with the extent that a proposal makes sound commercial sense influences its likely acceptance. Table 12.15 shows that for the total sample, this factor is important with a mean response of 5.25. Small hotels considered this factor more important (5.34) than medium sized hotels (5.33) and large hotels (5.06). Respondents from NZ hotels considered this factor more important (5.38) than respondents of Australian hotels (5.19).

<table>
<thead>
<tr>
<th>TABLE 12.15</th>
<th>Managerial intuition (questions 8d, 8f, 8k)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Australia</td>
</tr>
<tr>
<td></td>
<td>Sml</td>
</tr>
<tr>
<td><strong>8d) The proposal appears justifiable on intuitive grounds?</strong>  &lt;br&gt; (Scale: 1 = not at all, 7 = to a large extent)</td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>3.24</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.41</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
</tr>
<tr>
<td><strong>8f) Experience suggests that the project will be successful?</strong>  &lt;br&gt; (Scale: 1 = not at all, 7 = to a large extent)</td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>4.91</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.21</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
</tr>
<tr>
<td><strong>8k) On the face of it, the proposal makes sound commercial sense</strong>  &lt;br&gt; (Scale: 1 = not at all, 7 = to a large extent)</td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>5.33</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.16</td>
</tr>
<tr>
<td>n</td>
<td>33</td>
</tr>
</tbody>
</table>

12.5.11 Importance of quantitative vs. qualitative analysis in appraising investment proposals (question 9)

Question 9 posed the following statement: “In my hotel, quantitative analysis is more important than qualitative analysis when appraising investment proposals” A seven point Likert scale was provided with 1 being “strongly disagree” and 7 being “strongly agree”. Table 12.16 shows that for the total sample, quantitative analysis was considered slightly more important than qualitative analysis (4.59) when appraising investment proposals. Relative to NZ respondents, who scored a mean of 4.46, the Australian respondents attached greater importance to quantitative analysis, scoring a mean of 4.63.
TABLE 12.16
Importance of quantitative vs. qualitative analysis in appraising investment proposals
(question 9)

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th></th>
<th>New Zealand</th>
<th></th>
<th>Australia &amp; New Zealand</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sm</td>
<td>Med</td>
<td>Lge</td>
<td>Total</td>
<td>Sm</td>
<td>Med</td>
</tr>
</tbody>
</table>
| Question 9: In my hotel, quantitative analysis is more important than qualitative analysis when appraising investment proposals?
(Scale: 1 = strongly disagree, 7 = strongly agree) | Score  | 4.79 | 4.65 | 4.53 | 4.63 | 4.39 | 4.67 | 4.44 | 4.46 | 4.59 | 4.65 | 4.52 | 4.59 |
| Std. dev.            | 0.96 | 1.43 | 1.58 | 1.40 | 1.30 | 1.97 | 1.42 | 1.46 | 1.15 | 1.52 | 1.55 | 1.41 |
| n                    | 33  | 54  | 58  | 145  | 33  | 12  | 9   | 54   | 66  | 66  | 67  | 199  |

12.5.12 Propensity to bias capital budgeting proposals (questions 10, 11 and 12)

Questions 10, 11, and 12 were directed toward determining the propensity of respondents to bias capital budgeting proposals. For all three questions, a seven point Likert scale was adopted where a response of 1 meant ‘strongly disagree’ and 7 meant ‘strongly agree’. Table 12.17 shows a mean score for question 10 of 2.73, which indicates that respondents have a moderate level of disagreement that there would be a tendency for investment project sponsors (i.e. the managers most closely associated with the project’s initiation and development) to inflate projected cash inflow estimates in order to increase the likelihood of the project gaining the hotel owner’s support. Respondents of large hotels (2.54) had a higher level of disagreement than those from medium hotels (2.63) and small hotels (3.02).

Table 12.17 shows a mean score for question 11 of 2.66, which indicates that respondents have a moderate level of disagreement that revenue forecasts in capital budgeting proposals are typically overstated. Respondents of large hotels (2.31) had a higher level of disagreement than those from medium hotels (2.70) and small hotels (2.98).

Table 12.17 shows a mean score for question 12 of 2.82, which indicates that respondents have a moderate level of disagreement with the view that cost forecasts in capital budgeting proposals are typically understated. Respondents of large hotels (2.55) had a higher level of disagreement than those from medium hotels (2.86) and small hotels (3.06).
Questions 13, 14, and 15 were directed toward determining the extent to which hotel owners are inclined to engage in ego-trip hotel ownership. Table 12.18 provides the descriptive information gathered in connection with questions 13, 14, and 15. Question 13 posed the statement “The owner of my hotel derives considerable pride from the hotel’s appearance?” A seven point Likert scale was adopted where a response of 1 signified ‘strongly disagree’ and 7 signified ‘strongly agree’. The mean score of 5.29 in Table 12.18 shows that hotel owners derive considerable pride from their hotel’s appearance. Australian hotel owners appear to derive less pride from their hotels’ appearance (5.16) than the owners of NZ hotels (5.65).

Question 14 posed the statement “Ownership of my hotel appears to provide an ego-trip for the owner”. A seven point Likert scale was adopted where a response of 1 signified ‘strongly disagree’ and 7 signified ‘strongly agree’. The mean score of 2.57 in Table 12.18 shows that hotel owners generally do not derive much of an ego-trip from hotel ownership. Australian hotel owners appear to derive less ego-trip value (2.53) than NZ owners (2.65).
Question 15 posed the question “To what extent was the owner’s purchase of your hotel motivated by financial versus ostentatious considerations?” A seven point Likert scale was adopted where a response of 1 signified ‘mainly financial’ and 7 signified ‘mainly ostentatious’. The mean score of 2.57 in Table 12.18 shows that the motivation to purchase is typically more motivated by financial factors than ostentatious considerations. Australian hotel owners appear more financially oriented (2.49) than owners of NZ hotels (2.76).

<p>| Question 13: The owner of my hotel derives considerable pride from the hotel’s appearance? |
|---------------------------------------------------------------|------------------|------------------|
| (Scale: 1 = strongly disagree, 7 = strongly agree) | Australia | New Zealand | Australia &amp; New Zealand |</p>
<table>
<thead>
<tr>
<th>Score</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
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</thead>
<tbody>
<tr>
<td>5.52</td>
<td>4.93</td>
<td>5.18</td>
<td><strong>5.16</strong></td>
<td>5.85</td>
<td>4.92</td>
<td>5.88</td>
<td><strong>5.65</strong></td>
<td>5.69</td>
<td>4.92</td>
<td>5.26</td>
<td><strong>5.29</strong></td>
<td></td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.33</td>
<td>1.59</td>
<td>1.76</td>
<td><strong>1.61</strong></td>
<td>1.13</td>
<td>1.98</td>
<td>0.99</td>
<td><strong>1.38</strong></td>
<td>1.23</td>
<td>1.65</td>
<td>1.70</td>
<td><strong>1.56</strong></td>
</tr>
<tr>
<td>n</td>
<td>33</td>
<td>54</td>
<td>57</td>
<td><strong>144</strong></td>
<td>34</td>
<td>12</td>
<td>8</td>
<td><strong>54</strong></td>
<td>67</td>
<td>66</td>
<td>65</td>
<td><strong>198</strong></td>
</tr>
</tbody>
</table>

<p>| Question 14: Ownership of my hotel appears to provide an ego-trip for the owner? |
|---------------------------------------------------------------|------------------|------------------|
| (Scale: 1 = strongly disagree, 7 = strongly agree) | Australia | New Zealand | Australia &amp; New Zealand |</p>
<table>
<thead>
<tr>
<th>Score</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
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</thead>
<tbody>
<tr>
<td>2.55</td>
<td>2.85</td>
<td>2.23</td>
<td><strong>2.53</strong></td>
<td>2.79</td>
<td>2.42</td>
<td>2.44</td>
<td><strong>2.65</strong></td>
<td>2.67</td>
<td>2.77</td>
<td>2.26</td>
<td><strong>2.57</strong></td>
<td></td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.39</td>
<td>1.80</td>
<td>1.31</td>
<td><strong>1.54</strong></td>
<td>1.54</td>
<td>1.88</td>
<td>1.94</td>
<td><strong>1.66</strong></td>
<td>1.46</td>
<td>1.80</td>
<td>1.40</td>
<td><strong>1.57</strong></td>
</tr>
<tr>
<td>n</td>
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<td>54</td>
<td>57</td>
<td><strong>144</strong></td>
<td>33</td>
<td>12</td>
<td>9</td>
<td><strong>54</strong></td>
<td>66</td>
<td>66</td>
<td>66</td>
<td><strong>198</strong></td>
</tr>
</tbody>
</table>

<p>| Question 15: To what extent was the owner’s purchase of your hotel motivated by ostentatious versus financial considerations? |
|---------------------------------------------------------------|------------------|------------------|
| (Scale: 1 = mainly financial, 7 = mainly ostentatious) | Australia | New Zealand | Australia &amp; New Zealand |</p>
<table>
<thead>
<tr>
<th>Score</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
<th>Med</th>
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<tr>
<td>2.69</td>
<td>2.59</td>
<td>2.27</td>
<td><strong>2.49</strong></td>
<td>3.00</td>
<td>2.58</td>
<td>2.11</td>
<td><strong>2.76</strong></td>
<td>2.85</td>
<td>2.59</td>
<td>2.25</td>
<td><strong>2.57</strong></td>
<td></td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.62</td>
<td>1.79</td>
<td>1.56</td>
<td><strong>1.66</strong></td>
<td>1.87</td>
<td>2.19</td>
<td>1.62</td>
<td><strong>1.90</strong></td>
<td>1.75</td>
<td>1.85</td>
<td>1.55</td>
<td><strong>1.73</strong></td>
</tr>
<tr>
<td>n</td>
<td>32</td>
<td>54</td>
<td>55</td>
<td><strong>141</strong></td>
<td>34</td>
<td>12</td>
<td>9</td>
<td><strong>53</strong></td>
<td>66</td>
<td>66</td>
<td>64</td>
<td><strong>196</strong></td>
</tr>
</tbody>
</table>

**12.5.14 Owner involvement in the capital budgeting process (questions 16, 17, 18, 19)**

Questions 16, 17, 18, and 19 were directed at determining the extent to which owners are involved in the capital budgeting process in hotels governed by a management contract. Table 12.19 provides the descriptive information gathered in connection with these questions.

Question 16 asked: “To what extent is your hotel owner involved in the hotel’s capital budgeting process?” A seven point Likert scale was adopted where a response of 1 meant ‘not at all’ and 7 meant ‘to a large extent’. The mean score of 5.33 in Table 12.19 shows that owners of management contract hotels are generally fairly involved in the capital budgeting process. Owners of large hotels appear to have more involvement in the capital budgeting process (5.64) than owners of medium sized hotels (5.23) and small hotels (4.84).
Question 17 asked “How often does your hotel owner initiate capital budgeting proposals without being asked?” A seven point Likert scale was adopted where a response of 1 signified ‘never’ and 7 signified ‘very often’. The mean score of 3.32 in Table 12.19 signifies a moderate tendency for management contract hotel owners to initiate capital budgeting proposals without being asked. Owners of small hotels (3.52) appear to have a greater inclination to initiate capital budgeting proposals than owners of medium sized (3.28) and large hotels (3.26).

Question 18 asked “How much influence do you feel your hotel owner has on the final approved capital budget in your hotel?” A seven point Likert scale was adopted where a response of 1 signified ‘no influence’ and 7 signified ‘a great deal of influence’. The mean score of 5.82 in Table 12.19 suggests that management contract hotel owners exert considerable influence on the final approved capital budget. Owners of small hotels (5.00) appear to exert less influence on the final approved capital budget than owners of medium sized (5.90) and large hotels (6.12).

Question 19 asked “How do you view the nature of your hotel owner’s contribution to the capital budgeting process?” A seven point Likert scale was adopted where a response of 1 signified ‘not substantial’ and 7 signified ‘very substantial’. The mean score of 5.09 in Table 12.19 shows that contributions made by management contract hotel owners to the capital budgeting process are seen by the respondents to be reasonably substantial.
TABLE 12.19
Owner involvement in the capital budgeting process (questions 16, 17, 18, 19)

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>Question 16: To what extent is your hotel owner involved in the hotel’s capital budgeting process?</td>
<td>4.69</td>
<td>5.06</td>
<td>5.74</td>
</tr>
<tr>
<td>Score</td>
<td>1.80</td>
<td>1.71</td>
<td><strong>1.58</strong></td>
</tr>
<tr>
<td>Std. dev.</td>
<td>13</td>
<td>33</td>
<td>85</td>
</tr>
<tr>
<td>n</td>
<td>127</td>
<td>155</td>
<td>191</td>
</tr>
<tr>
<td>Question 17: How often does your hotel owner initiate capital budgeting proposals without being asked?</td>
<td>3.38</td>
<td>3.38</td>
<td>3.26</td>
</tr>
<tr>
<td>Score</td>
<td>2.06</td>
<td>1.86</td>
<td><strong>1.89</strong></td>
</tr>
<tr>
<td>Std. dev.</td>
<td>13</td>
<td>32</td>
<td>39</td>
</tr>
<tr>
<td>Question 18: How much influence do you feel your hotel owner has on the final approved capital budget in your hotel?</td>
<td>5.00</td>
<td>5.76</td>
<td>6.10</td>
</tr>
<tr>
<td>Score</td>
<td>1.68</td>
<td>1.41</td>
<td>0.88</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>13</td>
<td>33</td>
<td>39</td>
</tr>
<tr>
<td>Question 19: How do you view the nature of your hotel owner’s contribution to the capital budgeting process?</td>
<td>4.92</td>
<td>4.97</td>
<td>5.28</td>
</tr>
<tr>
<td>Score</td>
<td>1.80</td>
<td>1.51</td>
<td>1.52</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>13</td>
<td>33</td>
<td>39</td>
</tr>
<tr>
<td>n</td>
<td>127</td>
<td>155</td>
<td>191</td>
</tr>
</tbody>
</table>

12.5.15 Use of four common capital budgeting appraisal techniques (question 20)

Question 20 was directed at determining the extent to which four common capital budgeting appraisal techniques are used. These techniques were: (1) payback (question 20a); (2) net present value (question 20b); (3) average accounting rate of return (question 20c); and (4) internal rate of return (question 20d). Table 12.20 provides descriptive statistics relating to Question 20’s four sub-parts. For all four questions, a seven-point Likert scale was used with 1 signifying ‘not at all’ and 7 signifying ‘to a large extent’. The mean score of 5.52 on Question 20a suggests that payback is used most. Small hotels (4.89) use payback less than medium sized hotels (5.74) and large hotels (5.91). It appears Australian hotels (5.61) use payback more than NZ hotels (5.28). The mean score of 4.47 on question 20b suggests that net present value (NPV) is used to some extent. Small hotels (4.38) use NPV less than medium sized hotels (5.74) and large hotels (5.91). There is a suggestion of greater use of NPV amongst Australian hotels (4.55) relative to NZ hotels (4.24). The mean score of 4.16 on question 20c suggests that average accounting rate of return (AARR) is used to some extent. Australian responses suggest greater use of AARR (4.23) compared to NZ hotels (3.98). The mean score of 4.36 on
question 20d suggests that internal rate of return (IRR) is used to some extent. Small hotels (4.23) appear to use IRR less than large hotels (4.72) and greater use of IRR is made in Australian hotels (4.38) relative to NZ hotels (4.28).

### TABLE 12.20

Use of four common capital budgeting appraisal techniques (question 20)

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th></th>
<th>Australia &amp; New Zealand</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
<td>Total</td>
</tr>
<tr>
<td><strong>Question 20:</strong> To what extent are the following capital budgeting investment appraisal techniques used in your hotel? (Scale: 1 = not at all, 7 = to a large extent)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Score</strong></td>
<td>4.88</td>
<td>5.78</td>
<td>5.86</td>
<td><strong>5.61</strong></td>
</tr>
<tr>
<td><strong>Std. dev.</strong></td>
<td>1.59</td>
<td>1.37</td>
<td>1.16</td>
<td><strong>1.40</strong></td>
</tr>
<tr>
<td><strong>n</strong></td>
<td>33</td>
<td>54</td>
<td>38</td>
<td><strong>145</strong></td>
</tr>
<tr>
<td><strong>20b) Net present value (NPV)</strong></td>
<td>Score</td>
<td>4.55</td>
<td>3.98</td>
<td>5.09</td>
</tr>
<tr>
<td></td>
<td>Std. dev.</td>
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<td>1.83</td>
<td>1.51</td>
</tr>
<tr>
<td></td>
<td>n</td>
<td>33</td>
<td>54</td>
<td>58</td>
</tr>
<tr>
<td><strong>20c) Average accounting rate of return (AARR)</strong></td>
<td>Score</td>
<td>4.45</td>
<td>4.13</td>
<td>4.19</td>
</tr>
<tr>
<td></td>
<td>Std. dev.</td>
<td>1.39</td>
<td>1.89</td>
<td>1.82</td>
</tr>
<tr>
<td></td>
<td>n</td>
<td>33</td>
<td>54</td>
<td>58</td>
</tr>
<tr>
<td><strong>20d) Internal rate of return (IRR)</strong></td>
<td>Score</td>
<td>4.42</td>
<td>4.02</td>
<td>4.71</td>
</tr>
<tr>
<td></td>
<td>Std. dev.</td>
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<td>1.84</td>
<td>1.80</td>
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<tr>
<td></td>
<td>n</td>
<td>31</td>
<td>54</td>
<td>58</td>
</tr>
</tbody>
</table>

### 12.5.16 Original length of management contract (question 21)

Question 21 was directed at determining the original length of the management contract. Table 12.21 shows that the mean length of management contract was 12.78 years. Small hotels (8.27 years) have a tendency toward shorter management contract lengths compared to medium sized hotels (13.20 years) and large sized hotels (14.20 years).

### TABLE 12.21

Original length of management contract (question 21)

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th></th>
<th>Australia &amp; New Zealand</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
<td>Total</td>
</tr>
<tr>
<td><strong>No. of years</strong></td>
<td>7.45</td>
<td>13.24</td>
<td>14.13</td>
<td><strong>12.78</strong></td>
</tr>
<tr>
<td><strong>Std. dev.</strong></td>
<td>6.63</td>
<td>7.38</td>
<td>6.56</td>
<td><strong>7.16</strong></td>
</tr>
<tr>
<td><strong>n</strong></td>
<td>11</td>
<td>27</td>
<td>35</td>
<td><strong>73</strong></td>
</tr>
</tbody>
</table>
12.5.17 Number of years until management contract expires (question 22)

Question 22 was directed at determining the number of years until the management contract expires. Table 12.22 shows that the mean number of years until management contract expiration is 8.54 years. Small hotels (5.20 years) have a lower expiry period relative to medium sized hotels (8.67 years) and large sized hotels (9.74 years).

<table>
<thead>
<tr>
<th>No. of years</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
<th>Sml</th>
<th>Med</th>
<th>Lge</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian</td>
<td>4.45</td>
<td>8.87</td>
<td>9.50</td>
<td>8.51</td>
<td>7.25</td>
<td>7.60</td>
<td>12.50</td>
<td>8.71</td>
<td>5.20</td>
<td>8.67</td>
<td>9.74</td>
<td>8.54</td>
</tr>
<tr>
<td>NZ</td>
<td>5.03</td>
<td>6.05</td>
<td>5.48</td>
<td>5.83</td>
<td>5.38</td>
<td>2.70</td>
<td>4.77</td>
<td>4.46</td>
<td>5.09</td>
<td>5.64</td>
<td>5.43</td>
<td>5.63</td>
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<tr>
<td>Australia &amp; NZ</td>
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<td>27</td>
<td>35</td>
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<td>5</td>
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<td>12</td>
<td>15</td>
<td>32</td>
<td>38</td>
<td>85</td>
</tr>
</tbody>
</table>

12.5.18 Type of FF&E reserve (question 23)

Question 23 was directed at determining the type of FF&E reserve adopted. Table 12.23 shows that 51.5% of hotels adopt a cash FF&E reserve, 35.4% a notional FF&E reserve, and 13.1% no FF&E reserve. Small hotels make greater use of cash FF&E reserves (52.6%) and lesser use of notional FF&E reserves (26.3%) than large hotels (39.0% & 46.3% respectively). Small hotels, however, have a higher incidence of no FF&E reserves (14.6%) than large hotels (14.6%). Australian hotels (48.2%) used the cash FF&E reserve less than NZ hotels (68.8%). On the other hand, Australian hotels (37.3%) used notional FF&E reserves more than NZ hotels (25.0%). Australian hotels (14.5%) had a higher incidence of no FF&E reserves than NZ hotels (6.3%).

<table>
<thead>
<tr>
<th>Type of FF&amp;E reserve</th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>46.2%</td>
<td>66.7%</td>
<td>52.6%</td>
</tr>
<tr>
<td>Notional (non-cash)</td>
<td>30.8%</td>
<td>16.7%</td>
<td>26.3%</td>
</tr>
<tr>
<td>No FF&amp;E reserve</td>
<td>23.1%</td>
<td>16.7%</td>
<td>6.3%</td>
</tr>
<tr>
<td>Other</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>n</td>
<td>13</td>
<td>6</td>
<td>16</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Type of FF&amp;E reserve</th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>46.2%</td>
<td>66.7%</td>
<td>52.6%</td>
</tr>
<tr>
<td>Notional (non-cash)</td>
<td>30.8%</td>
<td>16.7%</td>
<td>26.3%</td>
</tr>
<tr>
<td>No FF&amp;E reserve</td>
<td>23.1%</td>
<td>16.7%</td>
<td>6.3%</td>
</tr>
<tr>
<td>Other</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>n</td>
<td>13</td>
<td>6</td>
<td>16</td>
</tr>
</tbody>
</table>
12.5.19 Percentage of gross revenue allocated annually (after ramping up) to the FF&E reserve account (question 24)

Question 24 was directed at determining percentage of gross revenue allocated annually (after ramping up) to the FF&E reserve account. Table 12.24 shows that the average allocation to the FF&E reserve was 3.02% of gross revenue. Australian hotels (3.04%) had a higher allocation than NZ hotels (2.92%). Medium sized hotels (3.08%) made higher allocations to the FF&E reserve than large hotels (2.99%) and small hotels (2.93%).

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sml %</td>
<td>3.06</td>
<td>3.04</td>
<td>3.02</td>
</tr>
<tr>
<td>Med %</td>
<td>3.13</td>
<td>2.95</td>
<td></td>
</tr>
<tr>
<td>Lge %</td>
<td>2.95</td>
<td>3.40</td>
<td></td>
</tr>
<tr>
<td>Total %</td>
<td>3.04</td>
<td>2.92</td>
<td></td>
</tr>
<tr>
<td>Std. dev.</td>
<td>0.83</td>
<td>0.83</td>
<td></td>
</tr>
<tr>
<td>n</td>
<td>9</td>
<td>27</td>
<td>68</td>
</tr>
</tbody>
</table>

12.5.20 Sufficiency of funds allocated to the FF&E reserve (question 25)

Question 25 was directed at determining sufficiency of funds allocated to the FF&E reserve. A seven point Likert scale was used with 1 being ‘not sufficient’ and 7 being ‘very sufficient’. Table 12.25 shows that the mean score was 3.81, which indicates that FF&E reserve allocations are viewed as moderately sufficient to fund FF&E expenditure. Australian hotels considered funds allocated to their FF&E reserve as more sufficient (3.84) than NZ hotels (3.67).

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sml</td>
<td>3.90</td>
<td>3.80</td>
<td>3.84</td>
</tr>
<tr>
<td>Med</td>
<td>3.80</td>
<td>3.80</td>
<td>3.80</td>
</tr>
<tr>
<td>Lge</td>
<td>3.85</td>
<td>3.00</td>
<td>5.00</td>
</tr>
<tr>
<td>Total</td>
<td>3.84</td>
<td>3.67</td>
<td>3.81</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>0.99</td>
<td>0.84</td>
<td>1.61</td>
</tr>
<tr>
<td>n</td>
<td>10</td>
<td>30</td>
<td>73</td>
</tr>
</tbody>
</table>
12.5.21 Percentage of gross revenue required to cover the true cost of reasonable annual FF&E expenditure (question 26)

Question 26 was directed at determining the percentage of gross revenue required to cover the true cost of reasonable annual FF&E expenditure. Table 12.26 shows that the mean percentage was 5.07%. Small hotels (5.81%) require a higher percentage of gross revenue to be allocated than medium sized hotels (5.00%) and large hotels (4.83%). Australian hotels appear to require more (5.16%) than NZ hotels (4.58).

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>Score</td>
<td>6.81</td>
<td>5.04</td>
<td>4.82</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>3.59</td>
<td>1.49</td>
<td>1.96</td>
</tr>
<tr>
<td>n</td>
<td>8</td>
<td>26</td>
<td>29</td>
</tr>
</tbody>
</table>

12.5.22 Release of funds from the FF&E reserve (questions 27, 28, 29)

Questions 27, 28, and 29 were directed at determining the ease with which funds are released from the FF&E reserve by the hotel owner. Table 12.27 provides the descriptive information gathered in connection with questions 27, 28, and 29. Question 27 posed the statement “In my hotel it can be hard to get the owner to release funds from the FF&E reserve”. A seven point Likert scale was adopted where a response of 1 meant ‘strongly disagree’ and 7 meant ‘strongly agree’. The mean score of 3.33 in Table 12.27 shows that there is weak disagreement with the view that owners make access to FF&E reserve funds hard. Owners of large hotels (2.92) appear to make the release of funds from the FF&E reserve easier than is the case in small (3.47) and medium sized hotels (3.68). Australian hotels (3.26) appear to have greater difficulty in getting owners to release funds than NZ hotels (3.67).

Question 28 asked “How often does your hotel owner refuse to release funds from the FF&E reserve?” A seven point Likert scale was adopted where a response of 1 signified ‘never’ and 7 signified ‘frequently’. The mean score of 2.72 in Table 12.27 suggests that hotel owners sometimes refuse to release funds from the FF&E reserve. Australian hotel owners (2.60) appear to refuse the release of funds less often than is the case in NZ hotels (3.27).
Question 29 asked “How much do you have to pressurise your hotel owner in order to get funds released from the FF&E reserve?”. A seven point Likert scale was adopted where a response of 1 signified ‘not at all’ and 7 signified ‘to a large extent’. The mean score of 3.17 in Table 12.27 shows that respondents sometimes need to pressurise the hotel owner to get funds released from the FF&E reserve. Respondents from small hotels appear to apply more pressure (3.60) than those in medium sized hotels (3.43) and large sized hotels (2.72). Respondents from Australian hotels indicate less pressuring of owners to release funds (3.04) than is the case in NZ hotels (3.80).

![TABLE 12.27](image)

12.5.23 Evaluation of the locus of power between hotel owner and hotel operator (question 30)

Question 30 posed 15 items concerned with evaluating the locus of power between hotel owner and operator in connection with 5 power themes. These are: (1) reward power (questions 30a, 30f, 30k); (2) coercive power (questions 30b, 30g, 30l); (3) legitimate power (questions 30c, 30h, 30m); (4) expert power (questions 30d, 30i, 30n); and (5) referent power (questions 30e, 30j, 30o). The following introductory sentence was provided “In terms of your hotel owner and your hotel operating company, which entity is in a stronger position to:” Following this, statements relating to the five power themes were provided. Following
each statement a seven point Likert scale ranging from 1 (the operator), 4 (both equally) and 7 (the owner) was presented. The following sections provide a discussion of the descriptive statistics concerning the 5 power themes.

12.5.23.1 Reward power (questions 30a, 30f, 30k)

Table 12.28 provides descriptive information regarding “reward power” (questions 30a, 30f, 30k). Question 30a was concerned with whether the hotel owner or operator was in a stronger position to provide the respondent with increased pay. The Table shows that for the total sample, the operator is typically in a stronger position (2.68). Within medium sized hotels operators typically hold more power (2.48) than in small (2.58) and large hotels (2.93). In NZ hotels, the operator is in a stronger position (2.44) than in Australian hotels (2.73).

Question 30f was concerned with whether the hotel owner or operator was in a stronger position to influence the respondent’s next promotion. The Table shows that for the total sample, the operator is strongest (2.23). Within Australian hotels, the operator is in a stronger position (2.21) than in NZ hotels (2.31).

Question 30k was concerned with whether the hotel owner or operator was in a stronger position to give the respondent special help and benefits in return for their co-operation. The Table shows that for the total sample, it is the operator that is typically in a stronger position (3.18). Within small hotels, the operator is stronger (2.84) than in medium sized hotels (3.10) and large hotels (3.41). The operator is stronger in NZ hotels (2.94) than in Australian hotels (3.23).
Table 12.28

<table>
<thead>
<tr>
<th>Question 30a: Provide you with increased pay?</th>
<th>Question 30f: Influence your next promotion?</th>
<th>Question 30k: Give you special help and benefits in return for your co-operation?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
<td>Score</td>
<td>Score</td>
</tr>
<tr>
<td>2.38</td>
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<td>2.92</td>
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<td>2.00</td>
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<tr>
<td>2.73</td>
<td>2.21</td>
<td>2.00</td>
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<td>3.00</td>
<td>3.00</td>
<td>1.67</td>
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<td>1.71</td>
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<td>3.00</td>
<td>1.92</td>
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<td>2.44</td>
<td>2.21</td>
<td>2.31</td>
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<tr>
<td>2.58</td>
<td>2.53</td>
<td>2.53</td>
</tr>
<tr>
<td>2.48</td>
<td>2.53</td>
<td>2.53</td>
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<tr>
<td>2.93</td>
<td>2.53</td>
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<td>2.53</td>
<td>2.53</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>Std. dev.</td>
<td>Std. dev.</td>
</tr>
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<td>1.38</td>
<td>1.22</td>
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<td>1.55</td>
<td>1.00</td>
<td>1.31</td>
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<tr>
<td>1.11</td>
<td>1.15</td>
<td>1.38</td>
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<td>1.73</td>
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<td>0.90</td>
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<td>1.46</td>
<td>1.58</td>
<td>1.15</td>
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<td>1.46</td>
<td>1.16</td>
<td>1.15</td>
</tr>
<tr>
<td>1.89</td>
<td>1.61</td>
<td>1.15</td>
</tr>
<tr>
<td>1.72</td>
<td>1.61</td>
<td>1.15</td>
</tr>
<tr>
<td>1.74</td>
<td>1.45</td>
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</tr>
<tr>
<td>101</td>
<td>101</td>
<td>101</td>
</tr>
</tbody>
</table>

12.5.23.2 Coercive power (questions 30b, 30g, 30l)

Table 12.29 provides descriptive information regarding “coercive power” (questions 30b, 30g, 30l). Question 30b was concerned with whether the hotel owner or operator was in a stronger position to put pressure on the respondent if they perceive them to not be supportive of their wishes. The Table shows that for the total sample, the operator is in a stronger position (3.33). The operator in Australian hotels is in a stronger position (3.31) than is the case in NZ hotels (3.44).

Question 30g was concerned with whether the hotel owner or operator was in a stronger position to make things unpleasant for the respondent at their hotel. The Table shows that for the total sample, there is approximately an even balance between the owner and operator (3.96). The operator in Australian hotels is in a slightly stronger position (3.94) whereas it is the owner that is in the slightly stronger position in NZ (4.06).

Question 30l was concerned with whether the hotel owner or operator was in a stronger position to make the respondent’s work difficult. The Table shows that for the total sample, the operator is in a slightly stronger position (3.79). The operator in NZ hotels is in a slightly stronger position (3.50) than is the case in Australian hotels (3.85).
12.5.23.3 Legitimate power (questions 30c, 30h, 30m)

Table 12.30 provides descriptive information regarding “legitimate power” (questions 30c, 30h, 30m). Question 30c was concerned with whether the hotel owner or operator was in a stronger position to require that their suggestions be carried out by the respondent. The Table shows that for the total sample, it is the operator who is typically in a stronger position (3.63). Within small hotels (3.47), the operator is typically in a stronger position than is the case in medium (3.60) and large sized hotels (3.74). The operator in Australia is in a stronger position (3.62) than is the case in NZ (3.69).

Question 30h was concerned with whether the hotel owner or operator was in a stronger position to give the respondent a sense of importance relating to fulfillment of their responsibilities. Table 12.30 shows that for the total sample, the operator is perceived to be in a stronger position (3.62). Within small hotels (3.53), the operator is typically in a stronger position than is the case in medium (3.58) and large sized hotels (3.71). Operators in NZ hotels are in a stronger position (3.50) than those in Australia (3.64).

Question 30m was concerned with whether the hotel owner or operator was in a stronger position to make the respondent want to achieve a high level of performance. The Table shows that for the total sample the operator is typically in a stronger position (3.50).
TABLE 12.3
Legitimate power (questions 30c, 30h, 30m)

<table>
<thead>
<tr>
<th></th>
<th>Australia</th>
<th>New Zealand</th>
<th>Australia &amp; New Zealand</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sml</td>
<td>Med</td>
<td>Lge</td>
</tr>
<tr>
<td>(Scale, 1 = the operator, 4 = both equally, 7 = the owner)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>30c) Require that their suggestions are carried out?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>3.54</td>
<td>3.58</td>
<td>3.62</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.56</td>
<td>1.41</td>
<td>1.06</td>
</tr>
<tr>
<td>N</td>
<td>13</td>
<td>33</td>
<td>85</td>
</tr>
<tr>
<td>30h) Give you a sense of importance associated with fulfilling your responsibilities?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>3.54</td>
<td>3.64</td>
<td>3.68</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.20</td>
<td>1.29</td>
<td>1.16</td>
</tr>
<tr>
<td>N</td>
<td>13</td>
<td>33</td>
<td>84</td>
</tr>
<tr>
<td>30m) Make you want to achieve a high level of performance?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Score</td>
<td>3.54</td>
<td>3.69</td>
<td>3.33</td>
</tr>
<tr>
<td>Std. dev.</td>
<td>1.56</td>
<td>1.33</td>
<td>1.49</td>
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<tr>
<td>N</td>
<td>13</td>
<td>32</td>
<td>39</td>
</tr>
</tbody>
</table>

12.5.23.4 Expert power (questions 30d, 30i, 30n)

Table 12.31 provides descriptive information regarding “expert power” (questions 30d, 30i, 30n). Question 30d concerned whether the hotel owner or operator was in a stronger position to command the respondent’s respect. The Table shows that for the total sample, the operator is typically in a slightly stronger position (3.91). The operator in Australian hotels (3.86) is typically in the stronger position whereas the owner tends to be in the stronger position (4.19) within NZ.

Question 30i was concerned with whether the hotel owner or operator was in a stronger position to provide the respondent with good technical suggestions. Table 12.31 shows that for the total sample, the operator is typically in a stronger position (2.77). Operators in NZ are perceived to be in a stronger position (2.69) relative to those in Australia (2.79).

Question 30n was concerned with whether the hotel owner or operator was in a stronger position to provide the respondent with sound job-related advice. The Table shows that for the total sample, the operator is typically in a stronger position (2.59). Operators in NZ are perceived to be in a stronger position (2.56) relative to those in Australia (2.60).
12.5.23.5 Referent power (questions 30e, 30j, 30o)

Table 12.32 provides descriptive data pertaining to “referent power” (questions 30e, 30j, 30o). Question 30e was concerned with whether the hotel owner or operator was in a stronger position to get the respondent to act in order to win their respect and admiration. The Table shows that for the total sample, the operator is in a slightly stronger position (3.80). The operator is in a stronger position in Australia (3.76) relative to NZ (4.00).

Question 30j was concerned with whether the hotel owner or operator was in a stronger position to make the respondent feel valued. The Table shows that for the total sample, the operator is typically in a stronger position (3.43). Operators in NZ are in a stronger position (3.00) relative to those in Australia (3.52).

Question 30o was concerned with whether the hotel owner or operator was in a stronger position to provide General Managers with a sense of being personally accepted. Table 12.32 shows that for the total sample, the operator is typically in a stronger position (3.46). Operators in Australia are in a stronger position (3.43) than those in NZ (3.63).
Table 12.3

Referent power (questions 30e, 30j, 30o)

<table>
<thead>
<tr>
<th>Question 30: In terms of your hotel owner and your hotel operating company, which entity is in a stronger position to: (Scale, 1 = the operator, 4 = both equally, 7 = the owner)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>3.38</td>
</tr>
<tr>
<td>3.91</td>
</tr>
<tr>
<td>3.76</td>
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<tr>
<td>4.00</td>
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</tr>
<tr>
<td>3.80</td>
</tr>
<tr>
<td>3.80</td>
</tr>
</tbody>
</table>

Table 12.3

Holistic power (question 31)

Question 31 was a holistic question concerned with determining the locus of power between hotel owners and operators. Following the question: “In terms of influencing the hotel’s objectives/goals, which is more powerful?” a seven point Likert scale was presented with 1 signifying ‘the operator’, 4 signifying ‘both equally’, and 7 signifying ‘the owner’. Table 12.33 shows that it is the operator that is perceived to be more powerful (3.21) than the owner. The operator is in a stronger position in small hotels (2.89) relative to medium sized hotels (3.13) and large hotels (3.44). Within NZ the operator is in a stronger position (2.88) than is the case in Australia (3.27).

Table 12.33

Holistic power (question 31)

<table>
<thead>
<tr>
<th>Question 31: In terms of influencing the hotel’s objectives / goals, which is more powerful? (Scale, 1 = the operator, 4 = both equally, 7 = the owner)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Score</td>
</tr>
<tr>
<td>-------</td>
</tr>
<tr>
<td>3.23</td>
</tr>
<tr>
<td>3.24</td>
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<td>3.32</td>
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<td>3.27</td>
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<td>2.17</td>
</tr>
<tr>
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<td>2.89</td>
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<tr>
<td>3.44</td>
</tr>
<tr>
<td>3.21</td>
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</tbody>
</table>
12.6 Conclusion

This chapter has described the administration of the questionnaire survey, the procedures that have been used to screen the questionnaire data collected, tests for non-response bias that have been undertaken, and the descriptive statistics concerning each of the questions posed by the questionnaire. Australian and NZ hotels with more than 20 rooms and a star-rating of three or more were included in the sampling frame. A five staged approach was taken to secure an adequate response rate, which involved two mailings of the questionnaire, distribution of the questionnaire by industry contacts, emailing of the questionnaire and the making of several follow up telephone calls. The response rate achieved was 32.21%.

Following the recommendations of Tabachnick and Fidell (2007), issues addressed concerning data screening included data input accuracy; out-of-range values; plausible means and standard deviations; univariate outliers; missing data; and normality. Tests in all these areas supported the view that data analysis for the descriptive information can be conducted on the data in its raw form. Tests for non-response bias highlighted some differences between the responses provided by early and late respondents on a few variables. In all cases, however, the effect of these systematic differences was only small. Other tests for non-response bias have failed to identify any noteworthy concerns. In light of the non-response investigations undertaken, it appears the threat of non-response bias is negligible.

Descriptive data collected by each question posed in the questionnaire has been analysed according to the country where the respondent works (i.e. Australia compared to NZ). In addition, a further analysis has been made according to hotel size. In this exercise, the sample has been split into three groups with the 33rd and 66th percentiles used as cut-off thresholds. This resulted in small sized hotels being categorised as those ranging from 20 to 105 rooms, medium sized hotels ranging from 106 rooms to 200 rooms, and large sized hotels having more than 201 rooms. The next chapter provides an investigation of those variables that will be involved in proposition testing that were measured using more than one item in the questionnaire. The thrust of the chapter concerns determining the degree to which the items used to measure the variables are measuring the same underlying theme or construct.
CHAPTER 13
DESCRIPTION OF KEY VARIABLES

13.1 Introduction

This chapter provides an investigation of those variables that will be involved in proposition testing and have been measured using more than one item in the questionnaire. The thrust of the chapter concerns determining the degree to which the items used to measure the variables are measuring the same underlying theme or construct. The remainder of the chapter is organised as follows. The next section provides an assessment of the suitability of the data set for factor analysis. The penultimate section details the way in which the variables will be measured. The final section provides a concluding commentary of the chapter.

13.2 Assessment of the suitability of the data set for factor analysis

For those variables involving three or more items in the questionnaire, an assessment of the suitability of the data for factor analysis was conducted. Hair et al. (2006) suggest that factor analysis is not normally conducted on a sample of fewer than 50 observations. As a general rule, it is preferable to have a sample size greater than 100 and to also have a minimum of at least five times as many observations as there are variables to be analysed (Hair, et al., 2006). For all variables under investigation, these requirements were met. The data set was therefore deemed suitable for factor analysis.

13.3 Variable measurement

Following the recommendations of Tabachnick and Fidell (2007), for those variables involving three or more items in the questionnaire, the following steps have been undertaken:

1. Preparation of a correlation analysis matrix to provide an initial appraisal of whether the items can be viewed as statistically associated;
2. Reporting of the Kaiser-Meyer-Olkin (KMO) measure to provide an indication of sampling adequacy;
3. Reporting of Bartlett’s Test of Sphericity to test for the presence of correlations in the matrix; and
4. Preparation of a factor analysis. Factors with an Eigenvalue greater than one are typically extracted. Communalities of items are reported in order to indicate the amount of variance in each variable that is shared with other variables along with an indication of the total variance explained for each of the factors extracted.

13.3.1 Variable 1: Hotel size (question 6)

As outlined earlier, hotel size was measured in both number of rooms and annual sales turnover. As the number of rooms in a hotel is the most commonly accepted measure of a hotel’s size (García-Falcon & Medina-Munoz, 1999; Vallen & Vallen, 2005), it was felt prudent that this measure be used to measure hotel size in proposition testing.

13.3.2 Variable 2: Hotel owner size (question 7)

As indicated earlier, hotel owner size was measured by both number of hotels owned and also number of hotel rooms owned. As no prior academic studies were found that had attempted to measure the size of a hotel owner, the decision was taken to use number of hotels owned to measure hotel owner size in proposition testing.

13.3.3 Variable 3: Factors influencing investment proposal acceptability (question 8)

Table 13.1 presents the correlation coefficient matrix for the 12 items pertaining to ‘factors influencing investment proposal acceptability’ (question 8). Items 8a – 8l correspond to question numbers 8a – 8l in the questionnaire. Strong inter-relationships are typically signified by correlation factors greater than 0.3 although items less than this can still be significant (Hair, et al., 2006). Items that are statistically significantly correlated at $p < .01$ as well as at $p < .05$ are highlighted in the Table. The extent of association between the items supports further investigation into the appropriateness of consolidating the items.
The KMO measure of sampling adequacy ranges between 0 and 1 (Hair, et al., 2006). The higher the KMO coefficient, the stronger the pattern of correlations (Hair, et al., 2006). Hair et al. (2006) explain that the KMO coefficient should be greater than .5 for a satisfactory factor analysis to proceed. The KMO measure of sampling adequacy yielded a strong association between the items in Table 13.1 of .789 and Bartlett’s Test of Sphericity was also significant ($p < .001$). These results provide strong support for proceeding to investigate item aggregation (the null hypothesis is that there is no association amongst the items).

Hair et al. (2006) explain that each variable’s communality needs to be assessed so that a decision can be made as to whether it meets acceptable levels of explanation. The typical guideline is that at least one-half of the variance of each variable must be taken into account. Therefore, variables with communalities less than .50 do not have sufficient explanation. Where variables exhibit communalities less than .50, Hair et al. (2006) suggest that if practical, it is possible to simply ignore or delete the variables. The communalities of the twelve items are presented in Table 13.2. The Table shows that only one item (8k) has a communality lower than .50 (at .473). Given that this item is very close to the .5 cut off, it was determined that the factor analysis could proceed based on all 12 items.

### TABLE 13.1
Correlations for ‘factors influencing capital investment proposal acceptability’
(question 8)

<table>
<thead>
<tr>
<th></th>
<th>8a</th>
<th>8b</th>
<th>8c</th>
<th>8d</th>
<th>8e</th>
<th>8f</th>
<th>8g</th>
<th>8h</th>
<th>8i</th>
<th>8j</th>
<th>8k</th>
<th>8l</th>
</tr>
</thead>
<tbody>
<tr>
<td>8a</td>
<td>1</td>
<td>.290**</td>
<td>.352**</td>
<td>-.076</td>
<td>.042</td>
<td>-.073</td>
<td>-.049</td>
<td>.076</td>
<td>.040</td>
<td>.438**</td>
<td>.228**</td>
<td>.483**</td>
</tr>
<tr>
<td>8b</td>
<td>.290**</td>
<td>1</td>
<td>.373**</td>
<td>.233**</td>
<td>.121</td>
<td>.118</td>
<td>.047</td>
<td>.067</td>
<td>.387**</td>
<td>.172*</td>
<td>.179*</td>
<td>.219**</td>
</tr>
<tr>
<td>8c</td>
<td>.352**</td>
<td>.373**</td>
<td>1</td>
<td>.059</td>
<td>.114</td>
<td>.085</td>
<td>.080</td>
<td>.160*</td>
<td>.294**</td>
<td>.409**</td>
<td>.151*</td>
<td>.375**</td>
</tr>
<tr>
<td>8d</td>
<td>-.076</td>
<td>.233**</td>
<td>.059</td>
<td>1</td>
<td>-.411**</td>
<td>.516**</td>
<td>.430**</td>
<td>.337**</td>
<td>.278**</td>
<td>-.123</td>
<td>.237**</td>
<td>-.052</td>
</tr>
<tr>
<td>8e</td>
<td>.042</td>
<td>.121</td>
<td>.114</td>
<td>.411**</td>
<td>1</td>
<td>.733**</td>
<td>.513**</td>
<td>.487**</td>
<td>.369**</td>
<td>.153*</td>
<td>.357**</td>
<td>.016</td>
</tr>
<tr>
<td>8f</td>
<td>-.073</td>
<td>.118</td>
<td>.085</td>
<td>.516**</td>
<td>.733**</td>
<td>1</td>
<td>.618**</td>
<td>.497**</td>
<td>.349**</td>
<td>.020</td>
<td>.390**</td>
<td>-.014</td>
</tr>
<tr>
<td>8g</td>
<td>-.049</td>
<td>.047</td>
<td>.080</td>
<td>.430**</td>
<td>.513**</td>
<td>.618**</td>
<td>1</td>
<td>.649**</td>
<td>.348**</td>
<td>.014</td>
<td>.329**</td>
<td>-.073</td>
</tr>
<tr>
<td>8h</td>
<td>.076</td>
<td>.067</td>
<td>.160*</td>
<td>.337**</td>
<td>.487**</td>
<td>.497**</td>
<td>.649**</td>
<td>1</td>
<td>.378**</td>
<td>.109</td>
<td>.344**</td>
<td>.078</td>
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<tr>
<td>8i</td>
<td>.040</td>
<td>.387**</td>
<td>.294**</td>
<td>.278**</td>
<td>.369**</td>
<td>.349**</td>
<td>.348**</td>
<td>.378**</td>
<td>1</td>
<td>.266**</td>
<td>.298**</td>
<td>.160*</td>
</tr>
<tr>
<td>8j</td>
<td>.438**</td>
<td>.172*</td>
<td>.409**</td>
<td>-.123</td>
<td>.153*</td>
<td>.020</td>
<td>.014</td>
<td>.109</td>
<td>.266**</td>
<td>1</td>
<td>.270**</td>
<td>.581**</td>
</tr>
<tr>
<td>8k</td>
<td>.228**</td>
<td>.179*</td>
<td>.151*</td>
<td>.237**</td>
<td>.357**</td>
<td>.390**</td>
<td>.329**</td>
<td>.344**</td>
<td>.298**</td>
<td>1</td>
<td>.305**</td>
<td>1</td>
</tr>
<tr>
<td>8l</td>
<td>.483**</td>
<td>.219**</td>
<td>.375**</td>
<td>-.052</td>
<td>.016</td>
<td>-.014</td>
<td>-.073</td>
<td>.078</td>
<td>.160*</td>
<td>.581**</td>
<td>.305**</td>
<td>1</td>
</tr>
</tbody>
</table>

**: Correlation is significant at the 0.01 level (2-tailed).
*: Correlation is significant at the 0.05 level (2-tailed).
A principal component analysis was undertaken and the results are presented in Table 13.3. Consistent with conventional practice (Hair et al., 2006), only factors with Eigenvalues greater than 1.0 were extracted. Three factors account for 62.086% of the variance. As it is common to consider a solution that accounts for 60% of the variance (and in some instances even less) as satisfactory in the social sciences (see Hair, et al., 2006), this solution is deemed acceptable.

Table 13.4 presents the results of the principal component analysis utilising the oblique rotation method with Kaiser Normalisation. According to Hair et al. (2006), factor loadings of .40 should be considered statistically significant ($p < .05$) with a sample of size of 200. To facilitate the analysis of the factors identified in the pattern matrix, theme names
corresponding to the appropriate questionnaire item numbers are provided in the second column.\(^1\)

<table>
<thead>
<tr>
<th>Questionnaire item</th>
<th>Item theme</th>
<th>Component 1</th>
<th>Component 2</th>
<th>Component 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>8f</td>
<td>Managerial intuition</td>
<td>.844</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8g</td>
<td>Internal political factors</td>
<td>.833</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8e</td>
<td>Internal political factors</td>
<td>.796</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8h</td>
<td>Internal political factors</td>
<td>.778</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8k</td>
<td>Managerial intuition</td>
<td>.557</td>
<td>.408</td>
<td></td>
</tr>
<tr>
<td>8d</td>
<td>Managerial intuition</td>
<td>.507</td>
<td>-.330</td>
<td>.393</td>
</tr>
<tr>
<td>8j</td>
<td>Financial analysis</td>
<td></td>
<td>.817</td>
<td></td>
</tr>
<tr>
<td>8l</td>
<td>Financial analysis</td>
<td></td>
<td>.813</td>
<td></td>
</tr>
<tr>
<td>8a</td>
<td>Financial analysis</td>
<td></td>
<td>.715</td>
<td></td>
</tr>
<tr>
<td>8b</td>
<td>Strategic analysis</td>
<td></td>
<td></td>
<td>.896</td>
</tr>
<tr>
<td>8i</td>
<td>Strategic analysis</td>
<td>.358</td>
<td>.537</td>
<td></td>
</tr>
<tr>
<td>8c</td>
<td>Strategic analysis</td>
<td>.439</td>
<td>.512</td>
<td></td>
</tr>
</tbody>
</table>

The principal component analysis findings in Table 13.4 suggest that it is appropriate to talk of three dimensions for ‘factors influencing capital investment proposal go-ahead’. Inspection of the scree plot provided in Figure 13.1, however, shows that there is quite a clear break between the second and third components. As a result, and in line with the recommendations of Hair et al. (2006), it has been determined that components 1 and 2 capture much more of the variance than the remaining components. Only two components were therefore extracted.

---

\(^1\) Recall that Question 8 covered the following 4 themes: (1) financial analysis (items 8a, 8j, 8l); (2) strategic analysis (8b, 8c, 8i); (3) internal political factors (8e, 8g, 8h); and (4) managerial intuition (8d, 8f, 8k).
Figure 13.1
Scree plot for ‘factors influencing capital investment proposal go-ahead’ (question 8)

Based on the principal component analysis findings, it appears appropriate to talk of the following two dimensions regarding ‘factors influencing capital investment proposal acceptability’:

1. Qualitative investment appraisal factors (questionnaire items 8f, 8g, 8e, 8h, 8k, 8d).
2. Quantitative investment appraisal factors (questionnaire items 8j, 8l, 8a).

Qualitative investment appraisal factors will be measured by calculating the mean of responses provided to questionnaire items 8f, 8g, 8e, 8h, 8k and 8d. These six variables yielded a strong Cronbach Alpha reliability statistic of .835. Quantitative investment appraisal factors will be measured by calculating the mean of questionnaire items 8j, 8l, and 8a. These three variables yielded an acceptable Cronbach Alpha of .750.

For the purposes of proposition testing, the two measures deriving from question 8 have been used to calculate an index of the emphasis attached to quantitative, relative to qualitative, investment appraisal factors. This has been achieved by subtracting the qualitative investment

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2 The lower limit for acceptability of the Cronbach Alpha is typically between .60 and .70 (Hair, et al., 2006).
appraisal emphasis measure (i.e. the mean of questionnaire items 8f, 8g, 8e, 8h, 8k and 8d) from the quantitative emphasis measure (i.e. the mean of questionnaire items 8j, 8l and 8a). A positive index mean of 1.92 results, signifying that the emphasis attached to quantitative capital investment appraisal measures (mean 5.95) is higher than the qualitative capital investment appraisal measures (mean 4.03).³

Question 9 posed the holistic statement “In my hotel, quantitative analysis is more important than qualitative analysis when appraising investment proposals” A seven point Likert scale was used with 1 being ‘strongly disagree’ and 7 ‘strongly agree’. The mean was 4.59. Unexpectedly, the correlations between the ‘index’ derived for question 8 and the ‘holistic’ measure in question 9 was not significant (at .051). When proposition testing, it would therefore appear prudent to compare regression models where the two items are switched as the measure of quantitative emphasis in investment appraisal, as there is no strong rationale for the exclusion of either one.

13.3.4 Variable 4: propensity of hotel management to positively bias capital budgeting proposals (questions 10 – 12)

Table 13.5 presents the correlation coefficient matrix for the 3 items pertaining to the ‘propensity of hotel management to positively bias capital budgeting proposals’ (questions 10 – 12). The Table highlights that all items are highly statistically significantly correlated at $p < 0.01$.

<table>
<thead>
<tr>
<th></th>
<th>Question 10</th>
<th>Question 11</th>
<th>Question 12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 10</td>
<td>1.000</td>
<td>.697**</td>
<td>.285**</td>
</tr>
<tr>
<td>Question 11</td>
<td>.697**</td>
<td>1.000</td>
<td>.509**</td>
</tr>
<tr>
<td>Question 12</td>
<td>.285**</td>
<td>.509**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**: Correlation is significant at the 0.01 level (2-tailed).

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.554) and Bartlett’s Test as significant ($p < .001$).

³ The Likert scale for Question 8 was 1 ‘not at all’ and 7 ‘to a large extent’.
Table 13.6 shows that the communality item loadings are well above the recommended .50 cut-off and statistically significant for questions 10 and 11, but not for question 12 (at .483). As the result for question 12 is very close to the recommended .5 cut off, the decision was made to include this item in the factor analysis.

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Initial</th>
<th>Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 10</td>
<td>1.000</td>
<td>.685</td>
</tr>
<tr>
<td>Question 11</td>
<td>1.000</td>
<td>.845</td>
</tr>
<tr>
<td>Question 12</td>
<td>1.000</td>
<td>.483</td>
</tr>
</tbody>
</table>

Table 13.7 presents the results of the total variance analysis. One component / factor had an Eigenvalue greater than 1. This factor explains 67.098% of the variance, which is deemed acceptable.

<table>
<thead>
<tr>
<th>Component</th>
<th>Total</th>
<th>% of variance</th>
<th>Cumulative %</th>
<th>Extraction sums of squared loadings</th>
<th>Total</th>
<th>% of variance</th>
<th>Cumulative %</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2.013</td>
<td>67.098</td>
<td>67.098</td>
<td>2.013</td>
<td>67.098</td>
<td>67.098</td>
<td></td>
</tr>
</tbody>
</table>

Table 13.8 provides the factor loadings emanating from a principal component un-rotated factor analysis. All item loadings are well above the recommended .40 cut off \( (p < .05) \) with a sample of size of 200 and are statistically significant.

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 11</td>
<td>.919</td>
</tr>
<tr>
<td>Question 10</td>
<td>.828</td>
</tr>
<tr>
<td>Question 12</td>
<td>.695</td>
</tr>
</tbody>
</table>
The principal component analysis findings provide support for viewing the three ‘propensity of hotel management to positively bias capital budgeting proposals’ questionnaire items as all “tapping into” the same factor. ‘Propensity of hotel management to positively bias capital budgeting proposals’ has therefore been measured by calculating the mean of questionnaire items 10, 11 and 12. These three variables yielded a Cronbach Alpha reliability statistic of .744.

13.3.5 Variable 5: Ego-trip ownership (questions 13 – 15)

Table 13.9 presents the correlation coefficient matrix for the 3 items pertaining to ‘ego-trip ownership’ (questions 13 – 15). The Table highlights that question 13 is statistically significantly correlated at \( p < .01 \) with question 15, but there is no significant association with question 14. This undermines the justifiability of conducting a factor analysis. Nevertheless, it was thought pertinent to conduct the KMO and Bartlett’s Test. The results of these analyses confirm that sampling adequacy is not achieved with the KMO being below the .5 cut off at .421.

```
<table>
<thead>
<tr>
<th></th>
<th>Question 13</th>
<th>Question 14</th>
<th>Question 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 13</td>
<td>1</td>
<td>.137</td>
<td>-.189**</td>
</tr>
<tr>
<td>Question 14</td>
<td>.137</td>
<td>1</td>
<td>.135</td>
</tr>
<tr>
<td>Question 15</td>
<td>-.189**</td>
<td>.135</td>
<td>1</td>
</tr>
</tbody>
</table>
```

**Note:** Correlation is significant at the 0.01 level (2-tailed).

As a result of this analysis, it was determined that ‘ego-trip ownership’ would be measured by calculating the mean of items 13 and 15.

13.3.6 Variable 6: Hotel owner involvement in the preparation of capital budgeting proposals (questions 16 - 19)

Table 13.10 presents the results of a correlation analysis of the four ‘hotel owner involvement in the preparation of capital budgeting proposals’ (questions 16 – 19) items. The Table highlights items that are statistically significantly correlated at \( p < .01 \) as well as at \( p < .05 \).
The extent of association between the items supports further investigation into the appropriateness of consolidating the items.

**TABLE 13.10**
Correlations for ‘hotel owner involvement in the preparation of capital budgeting proposals’ (questions 16 - 19)

<table>
<thead>
<tr>
<th>Question 16</th>
<th>Question 17</th>
<th>Question 18</th>
<th>Question 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 16</td>
<td>1.000</td>
<td>.091</td>
<td>.496**</td>
</tr>
<tr>
<td>Question 17</td>
<td>.091</td>
<td>1.000</td>
<td>.103</td>
</tr>
<tr>
<td>Question 18</td>
<td>.496**</td>
<td>.103</td>
<td>1.000</td>
</tr>
<tr>
<td>Question 19</td>
<td>.352**</td>
<td>.253*</td>
<td>.328**</td>
</tr>
</tbody>
</table>

**: Correlation is significant at the 0.01 level (2-tailed).
*: Correlation is significant at the 0.05 level (2-tailed).

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.636) and Bartlett’s Test as significant ($p < .001$).

Table 13.11 presents the communality results. All items exhibit a greater than a .5 cut off except for question 17, which had a low communality of .149. The decision was therefore made to remove question 17 from the factor analysis.

**TABLE 13.11**
Communalities for ‘hotel owner involvement in the preparation of capital budgeting proposals’ (questions 16 - 19)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Initial</th>
<th>Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 16</td>
<td>1.000</td>
<td>.604</td>
</tr>
<tr>
<td>Question 17</td>
<td>1.000</td>
<td>.149</td>
</tr>
<tr>
<td>Question 18</td>
<td>1.000</td>
<td>.589</td>
</tr>
<tr>
<td>Question 19</td>
<td>1.000</td>
<td>.521</td>
</tr>
</tbody>
</table>

After dropping question 17 from the factor analysis, Table 13.12 presents the results of the total variance analysis. Although Hair et al. (2006) recommend that only factors with Eigenvalues greater than 1.0 be extracted, when this was carried out it resulted in only one component accounting for 59.636% of the variance, which was very close to Hair et al.’s (2006) recommendation that an acceptable solution for a component accounts for more than 60% of the variance.
Table 13.12 presents the results of the principal component analysis utilising the oblique rotation method with Kaiser Normalisation. It is important to note that according to Hair et al. (2006), factor loadings of .55 should be considered statistically significant $p < .05$ with a sample of size of 100. All item loadings are well above this recommended .55 cut off ($p < .05$) and are therefore statistically significant.

Table 13.13 presents the results of the principal component analysis utilising the oblique rotation method with Kaiser Normalisation. It is important to note that according to Hair et al. (2006), factor loadings of .55 should be considered statistically significant $p < .05$ with a sample of size of 100. All item loadings are well above this recommended .55 cut off ($p < .05$) and are therefore statistically significant.

### TABLE 13.12

<table>
<thead>
<tr>
<th>Component</th>
<th>Initial Eigenvalues</th>
<th>Extraction sums of squared loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>% of variance</td>
</tr>
<tr>
<td>1</td>
<td>1.789</td>
<td>59.636</td>
</tr>
</tbody>
</table>

### TABLE 13.13

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 16</td>
<td>.814</td>
</tr>
<tr>
<td>Question 18</td>
<td>.801</td>
</tr>
<tr>
<td>Question 19</td>
<td>.696</td>
</tr>
</tbody>
</table>

‘Hotel owner involvement in the preparation of capital budgeting proposals’ has therefore been measured by calculating the mean of questionnaire items 16, 18 and 19. These three variables yielded an acceptable Cronbach Alpha of .653.

### 13.3.7 Variable 7: Emphasis attached to sophisticated quantitative capital budgeting techniques (question 20)

Question 20 was concerned with determining the emphasis attached to sophisticated quantitative capital budgeting techniques. Items 20a – 20d determined the relative usage of: (1) payback (20a); (2) NPV (20b); (3) AARR (20c); and IRR (20d). NPV and IRR were considered sophisticated and payback and AARR simple capital investment appraisal techniques. As it is difficult to come up with a measure of sophistication, for the purposes of proposition testing, it was thought pertinent to develop two measures.\(^4\)

\(^4\) It is noted that these are only two of several potential approaches to generating an ‘index’ of sophistication.
The first measure is a single index concerning the use of sophisticated versus simple capital investment appraisal techniques. As there is no need to determine the degree of alignment between items 20a – 20d, factor analysis has not been undertaken. Instead, it was decided to take the most dominant item within both dimensions and to calculate an ‘index of sophistication’ by subtracting the subject’s score for the simple item from their score for the sophisticated item.

Table 13.14 provides the mean, standard deviation and sample size of items 20 – 20d. NPV (item 20b) is selected as the dominant sophisticated technique while payback (item 20a) is chosen as the dominant simple technique. It was found that the mean of this ‘index of sophistication’ was -1.05 ((NPV (4.47) – payback (5.52)).

<table>
<thead>
<tr>
<th></th>
<th>20a (payback)</th>
<th>20b (NPV)</th>
<th>20c (AARR)</th>
<th>20d (IRR)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scale:</strong></td>
<td></td>
<td></td>
<td>1 = not at all, 7 = to a large extent</td>
<td></td>
</tr>
<tr>
<td><strong>Mean</strong></td>
<td>5.52</td>
<td>4.47</td>
<td>4.16</td>
<td>4.36</td>
</tr>
<tr>
<td><strong>Std. dev.</strong></td>
<td>1.51</td>
<td>1.75</td>
<td>1.75</td>
<td>1.77</td>
</tr>
<tr>
<td><strong>n</strong></td>
<td>199</td>
<td>199</td>
<td>199</td>
<td>197</td>
</tr>
</tbody>
</table>

Guilding and Lamminmaki (2007) discussed that it might be pertinent to speak of a ‘group’ of techniques as being either sophisticated or simple. With regard to the second measure of sophistication, it was decided to take the subject’s scores for both the simple items (i.e. payback and AARR) and both the sophisticated items (i.e. NPV and IRR) and to calculate this second ‘index of sophistication 2’ by subtracting the subject’s scores for both of the simple items from their scores for both of the sophisticated items. The formula can be expressed as follows:

\[(\text{NPV} + \text{IRR}) - (\text{Payback} + \text{AARR}) = \text{index of sophistication 2}\]

It was found that the mean ‘index of sophistication 2’ was -0.84 \(((\text{NPV} (4.47) + \text{IRR} (4.36)) – ((\text{payback} (5.52) + \text{AARR} (4.16))).
13.3.8 Variable 8: Adequacy of funds allocated to the FF&E reserve account (questions 24 – 26)

Questions 24, 25 and 26 were directed towards determining the adequacy of funds allocated to the FF&E reserve account. Questions 24 and 26 involved answers in the form of absolute numbers while one of the questions (question 25) involved a Likert scale.

With respect to developing a single measure for ‘adequacy of funds allocated to the FF&E reserve account’, firstly, an index was computed by taking a subject’s score for question 24 (i.e. actual allocation to the FF&E reserve) and deducting their score on question 26 (i.e. true cost of FF&E reserve). This index provides an indication of the relative inadequacy of annual FF&E reserve allocations. The mean annual percentage of gross revenue allocated (after ramping up), (question 24) was 3.02% while the mean annual percentage of gross revenue required to cover the true cost of reasonable annual FF&E expenditure (after ramping up) (question 26) was 5.07%. The mean index for inadequacy of funds allocated to the FF&E reserve account is therefore -2.06%.

The second step in determining the most appropriate way in which to measure ‘adequacy of funds allocated to the FF&E reserve account’ is to calculate the correlation between the ‘index’ (i.e. mean of question 24 less mean of question 26) and question 25. The two items are statistically significantly correlated (.532) at $p < .01$.

As the two items are statistically significantly correlated, a decision has to be made whether to use the ‘index’ (Q24 - Q26) or question 25 in proposition testing. As the ‘index’ uses absolute numbers (as opposed to a Likert scale in question 25), it was decided that the ‘index’ represents a more reliable measure than question 25 and would therefore be adopted.

13.3.9 Variable 9: Hotel owner propensity to release FF&E reserve account funds (questions 27 – 29)

Table 13.15 presents the correlation coefficient matrix for the 3 items pertaining to the ‘hotel owner propensity to release FF&E reserve account funds’ (questions 27 – 29). The Table highlights that all items are highly statistically significantly correlated at $p < .01$. 

TABLE 13.15
Correlations for ‘hotel owner propensity to release FF&E reserve account funds’
(questions 27 – 29)

<table>
<thead>
<tr>
<th></th>
<th>Question 27</th>
<th>Question 28</th>
<th>Question 29</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 27</td>
<td>1.000</td>
<td>.751**</td>
<td>.786**</td>
</tr>
<tr>
<td>Question 28</td>
<td>.751**</td>
<td>1.000</td>
<td>.698**</td>
</tr>
<tr>
<td>Question 29</td>
<td>.786**</td>
<td>.698**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**: Correlation is significant at the 0.01 level (2-tailed).

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.740) and Bartlett’s Test as significant ($p < .001$).

Table 13.16 presents the communality results. All are greater than a .5 cut off and are therefore acceptable.

TABLE 13.16
Communalities for ‘hotel owner propensity to release FF&E reserve account funds’
(questions 27 – 29)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Initial</th>
<th>Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 27</td>
<td>1.000</td>
<td>.865</td>
</tr>
<tr>
<td>Question 28</td>
<td>1.000</td>
<td>.799</td>
</tr>
<tr>
<td>Question 29</td>
<td>1.000</td>
<td>.826</td>
</tr>
</tbody>
</table>

Table 13.17 presents the results of the total variance analysis. One component factor had an Eigenvalue greater than 1. This factor explains 83.018% of the variance, which is deemed very acceptable.

TABLE 13.17
Total variance explained for ‘hotel owner propensity to release FF&E reserve account funds’ (questions 27 – 29)

<table>
<thead>
<tr>
<th>Component</th>
<th>Initial Eigenvalues</th>
<th>Extraction sums of squared loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>% of variance</td>
</tr>
<tr>
<td>1</td>
<td>2.491</td>
<td>83.018</td>
</tr>
</tbody>
</table>
Table 13.18 provides the factor loadings emanating from a principal component un-rotated factor analysis. All item loadings are well above the recommended .55 cut off ($p < .05$) with a sample of size of 100 and are statistically significant.

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 27</td>
<td>.930</td>
</tr>
<tr>
<td>Question 29</td>
<td>.909</td>
</tr>
<tr>
<td>Question 28</td>
<td>.894</td>
</tr>
</tbody>
</table>

The principal component analysis findings provide support for viewing the three ‘hotel owner propensity to release FF&E reserve account funds’ questionnaire items as all “tapping into” the same factor. ‘Hotel owner propensity to release FF&E reserve account funds’ has therefore been measured by calculating the mean of questionnaire items 27, 28 and 29. These three variables yielded a very acceptable Cronbach Alpha reliability statistic of .895.

13.3.10 Variable 10: Locus of power between hotel owner and hotel operator (question 30)

Question 30 comprised 15 items (questions 30a – 30o) and sought to measure the locus of power between hotel owner and hotel operator across five different power bases. These power bases comprise: (1) reward power (questions 30a, 30f, 30k); (2) coercive power (questions 30b, 30g, 30l); (3) legitimate power (questions 30c, 30h, 30m); (4) expert power (questions 30d, 30i, 30n); and (5) referent power (questions 30e, 30j, 30o). Consistent with the view (see French & Raven, 1960) that power is a multidimensional variable, no attempt has been made to explore the extent of association between all 15 items. Instead, the degree of association between the three items comprising each dimension of power has been investigated.

13.3.10.1 Reward power (questions 30a, 30f, 30k)

Table 13.19 presents the correlation coefficient matrix for the 3 items pertaining to ‘reward power’ (questions 30a, 30f, 30k). The Table highlights that all items are highly statistically significantly correlated at $p < .01$. 

252
TABLE 13.19
Correlations for ‘reward power’ (questions 30a, 30f, 30k)

<table>
<thead>
<tr>
<th></th>
<th>Question 30a</th>
<th>Question 30f</th>
<th>Question 30k</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30a</td>
<td>1.000</td>
<td>.461**</td>
<td>.533**</td>
</tr>
<tr>
<td>Question 30f</td>
<td>.461**</td>
<td>1.000</td>
<td>.355**</td>
</tr>
<tr>
<td>Question 30k</td>
<td>.533**</td>
<td>.355**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**: Correlation is significant at the 0.01 level (2-tailed).

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.648) and Bartlett’s Test as significant $(p < .001)$.

Table 13.20 presents the communality results. All are greater than a .5 cut off and are therefore acceptable.

TABLE 13.20
Communalities for ‘reward power’ (questions 30a, 30f, 30k)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Initial</th>
<th>Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30a</td>
<td>1.000</td>
<td>.720</td>
</tr>
<tr>
<td>Question 30f</td>
<td>1.000</td>
<td>.555</td>
</tr>
<tr>
<td>Question 30k</td>
<td>1.000</td>
<td>.629</td>
</tr>
</tbody>
</table>

Table 13.21 presents the results of the total variance analysis. One component / factor had an Eigenvalue greater than 1. This factor explains an acceptable 63.460% of the variance.

TABLE 13.21
Total variance explained for ‘reward power’ (questions 30a, 30f, 30k)

<table>
<thead>
<tr>
<th>Component</th>
<th>Initial Eigenvalues</th>
<th>Extraction sums of squared loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>% of variance</td>
</tr>
<tr>
<td>1</td>
<td>1.904</td>
<td>63.460</td>
</tr>
</tbody>
</table>

Table 13.22 provides the factor loadings emanating from a principal component un-rotated factor analysis. All item loadings are well above the recommended .55 cut off $(p < .05)$ with a sample of size of 100 and are statistically significant.
The principal component analysis findings provide support for viewing the three ‘reward power’ (questions 30a, 30f, 30k) questionnaire items as all “tapping into” the same factor. ‘Reward power’ (questions 30a, 30f, 30k) has therefore been measured by calculating the mean of questionnaire items 30a, 30f and 30k. These three variables yielded an acceptable Cronbach Alpha reliability statistic of .709.

### 13.3.10.2 Coercive power (questions 30b, 30g, 30l)

Table 13.23 presents the correlation coefficient matrix for the 3 items pertaining to ‘coercive power’ (questions 30b, 30g, 30l). The Table highlights that all items are highly statistically significantly correlated at $p < .001$.

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30a</td>
<td>.848</td>
</tr>
<tr>
<td>Question 30k</td>
<td>.793</td>
</tr>
<tr>
<td>Question 30f</td>
<td>.745</td>
</tr>
</tbody>
</table>

**TABLE 13.22**

Component matrix for ‘reward power’ (questions 30a, 30f, 30k)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30b</td>
<td>1.000</td>
</tr>
<tr>
<td>Question 30g</td>
<td>.375**</td>
</tr>
<tr>
<td>Question 30l</td>
<td>.385**</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Initial</th>
<th>Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30b</td>
<td>1.000</td>
<td>.534</td>
</tr>
<tr>
<td>Question 30g</td>
<td>1.000</td>
<td>.648</td>
</tr>
<tr>
<td>Question 30l</td>
<td>1.000</td>
<td>.658</td>
</tr>
</tbody>
</table>

**TABLE 13.23**

Correlations for ‘coercive power’ (questions 30b, 30g, 30l)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30a</td>
<td>.848</td>
</tr>
<tr>
<td>Question 30k</td>
<td>.793</td>
</tr>
<tr>
<td>Question 30f</td>
<td>.745</td>
</tr>
</tbody>
</table>

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.654) and Bartlett’s Test as significant ($p < .001$).

Table 13.24 presents the communality results. All are greater than a .5 cut off and are therefore acceptable.

**TABLE 13.24**

Communalities for ‘coercive power’ (questions 30b, 30g, 30l)
Table 13.25 presents the results of the total variance analysis. One component / factor had an Eigenvalue greater than 1. This factor explains an acceptable 61.348% of the variance.

<table>
<thead>
<tr>
<th>Component</th>
<th>Initial Eigenvalues</th>
<th>Extraction sums of squared loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total % of variance</td>
<td>Cumulative % Total % of variance Cumulative %</td>
</tr>
<tr>
<td>1</td>
<td>1.840 61.348</td>
<td>61.348 1.840 61.348 61.348</td>
</tr>
</tbody>
</table>

Table 13.26 provides the factor loadings emanating from a principal component un-rotated factor analysis. All item loadings are well above the recommended .55 cut off ($p < .05$) with a sample of size of 100 and are statistically significant.

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30l</td>
<td>.811</td>
</tr>
<tr>
<td>Question 30g</td>
<td>.805</td>
</tr>
<tr>
<td>Question 30b</td>
<td>.731</td>
</tr>
</tbody>
</table>

The principal component analysis findings provide support for viewing the three ‘coercive power’ (questions 30b, 30g, 30l) questionnaire items as all “tapping into” the same factor. ‘Coercive power’ (questions 30b, 30g, 30l) has therefore been measured by calculating the mean of questionnaire items 30b, 30g and 30l. These three variables yielded an acceptable Cronbach Alpha reliability statistic of .681.

### 13.3.10.3 Legitimate power (questions 30c, 30h, 30m)

Table 13.27 presents the correlation coefficient matrix for the 3 items pertaining to ‘legitimate power’ (questions 30c, 30h, 30m). The Table highlights that all items are highly statistically significantly correlated at $p < .001$. 
### TABLE 13.27
Correlations for ‘legitimate power’ (questions 30c, 30h, 30m)

<table>
<thead>
<tr>
<th></th>
<th>Question 30c</th>
<th>Question 30h</th>
<th>Question 30m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30c</td>
<td>1.000</td>
<td>.318**</td>
<td>.276**</td>
</tr>
<tr>
<td>Question 30h</td>
<td>.318**</td>
<td>1.000</td>
<td>.597**</td>
</tr>
<tr>
<td>Question 30m</td>
<td>.276**</td>
<td>.597**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.594) and Bartlett’s Test as significant ($p < .001$).

Table 13.28 presents the communality results. Question 30h and 30m are greater than the .5 cut off but 30c (at .382) is below this threshold. In line with Hair et al. (2006), where variables have communalities less than .50, it is possible to simply ignore those variables, or, delete the variables. As item 30c is a measure that has been subjected to testing in earlier studies (see Chapter 11), it is preferred to retain item 30c within the factor solution.

### TABLE 13.28
Communalities for ‘legitimate power’ (questions 30c, 30h, 30m)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Initial</th>
<th>Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30c</td>
<td>1.000</td>
<td>.382</td>
</tr>
<tr>
<td>Question 30h</td>
<td>1.000</td>
<td>.731</td>
</tr>
<tr>
<td>Question 30m</td>
<td>1.000</td>
<td>.700</td>
</tr>
</tbody>
</table>

Table 13.29 presents the results of the total variance analysis. One component/factor had an Eigenvalue greater than 1. This factor explains an acceptable 60.449% of the variance.

### TABLE 13.29
Total variance explained for ‘legitimate power’ (questions 30c, 30h, 30m)

<table>
<thead>
<tr>
<th></th>
<th>Initial Eigenvalues</th>
<th>Extraction sums of squared loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component</td>
<td>Total</td>
<td>% of variance</td>
</tr>
<tr>
<td>1</td>
<td>1.813</td>
<td>60.449</td>
</tr>
</tbody>
</table>

Table 13.30 provides the factor loadings emanating from a principal component un-rotated factor analysis. All item loadings are well above the recommended .55 cut off ($p < .05$) with a sample of size of 100 and are statistically significant.
The principal component analysis findings provide support for viewing the three ‘legitimate power’ (questions 30c, 30h, 30m) questionnaire items as all “tapping into” the same factor. ‘Legitimate power’ (questions 30c, 30h, 30m) has therefore been measured by calculating the mean of questionnaire items 30c, 30h and 30m. These three variables yield an acceptable Cronbach Alpha reliability statistic of .669.

13.3.10.4 Expert power (questions 30d, 30i, 30n)

Table 13.31 presents the correlation coefficient matrix for the 3 items pertaining to ‘expert power’ (questions 30d, 30i, 30n). The Table highlights that all items are highly statistically significantly correlated at $p < .001$.

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.606) and Bartlett's Test as significant ($p < .001$).

Table 13.32 presents the communality results. Question 30i and 30n are greater than the .5 cut off but question 30d (at .411) is below this threshold. As already noted, where variables have communalities less than .50 it is possible to simply ignore or delete the variables. As item 30d is a measure that has been previously tested in earlier studies (see Chapter 11), the measure’s internal consistency is thought to be good. As a result, it is preferred to retain item 30d within the factor solution.
**TABLE 13.32**

Communalities for ‘expert power’ (questions 30d, 30i, 30n)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Initial</th>
<th>Extraction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30d</td>
<td>1.000</td>
<td>.411</td>
</tr>
<tr>
<td>Question 30i</td>
<td>1.000</td>
<td>.719</td>
</tr>
<tr>
<td>Question 30n</td>
<td>1.000</td>
<td>.736</td>
</tr>
</tbody>
</table>

Table 13.33 presents the results of the total variance analysis. One component / factor had an Eigenvalue greater than 1. This factor explains an acceptable 62.197% of the variance.

**TABLE 13.33**

Total variance explained for ‘expert power’ (questions 30d, 30i, 30n)

<table>
<thead>
<tr>
<th>Component</th>
<th>Initial Eigenvalues</th>
<th>Extraction sums of squared loadings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>% of variance</td>
</tr>
<tr>
<td>1</td>
<td>1.866</td>
<td>62.197</td>
</tr>
</tbody>
</table>

Table 13.34 provides the factor loadings emanating from a principal component un-rotated factor analysis. All item loadings are well above the recommended .55 cut off ($p < .05$) with a sample of size of 100, and are statistically significant.

**TABLE 13.34**

Component matrix for ‘expert power’ (questions 30d, 30i, 30n)

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30d</td>
<td>.858</td>
</tr>
<tr>
<td>Question 30i</td>
<td>.848</td>
</tr>
<tr>
<td>Question 30n</td>
<td>.641</td>
</tr>
</tbody>
</table>

The principal component analysis findings provide support for viewing the three ‘expert power (questions 30d, 30i, 30n)’ questionnaire items as all “tapping into” the same factor. ‘Expert power’ (questions 30d, 30i, 30n) has therefore been measured by calculating the mean of questionnaire items 30d, 30i and 30n. These three variables yielded an acceptable Cronbach Alpha reliability statistic of .692.
13.3.10.5 Referent power (questions 30e, 30j, 30o)

Table 13.35 presents the correlation coefficient matrix for the 3 items pertaining to ‘referent power’ (questions 30e, 30j, 30o). The Table highlights that all items are highly statistically significantly correlated at $p < .01$.

<table>
<thead>
<tr>
<th>Correlations for ‘referent power’ (questions 30e, 30j, 30o)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30e</td>
</tr>
<tr>
<td>Question 30j</td>
</tr>
<tr>
<td>Question 30o</td>
</tr>
</tbody>
</table>

**: Correlation is significant at the 0.01 level (2-tailed).

KMO and Bartlett’s Test were conducted with results displaying sampling adequacy as favourable (.656) and Bartlett’s Test as significant ($p < .001$).

Table 13.36 presents the communality results. All are greater than a .5 cut off and are therefore acceptable.

<table>
<thead>
<tr>
<th>Communalities for ‘referent power’ (questions 30e, 30j, 30o)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Questionnaire items</td>
</tr>
<tr>
<td>Question 30e</td>
</tr>
<tr>
<td>Question 30j</td>
</tr>
<tr>
<td>Question 30o</td>
</tr>
</tbody>
</table>

Table 13.37 presents the results of the total variance analysis. One component / factor had an Eigenvalue greater than 1. This factor explains an acceptable 67.134% of the variance.

<table>
<thead>
<tr>
<th>Total variance explained for ‘referent power’ (questions 30e, 30j, 30o)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component</td>
</tr>
<tr>
<td>------------</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>1</td>
</tr>
</tbody>
</table>
Table 13.38 provides the factor loadings emanating from a principal component un-rotated factor analysis. All item loadings are well above the recommended .55 cut off (\(p < .05\)) with a sample of size of 100 and are statistically significant.

<table>
<thead>
<tr>
<th>Questionnaire items</th>
<th>Component 1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 30j</td>
<td>.865</td>
</tr>
<tr>
<td>Question 30o</td>
<td>.851</td>
</tr>
<tr>
<td>Question 30e</td>
<td>.737</td>
</tr>
</tbody>
</table>

The principal component analysis findings provide support for viewing the three ‘referent power’ (questions 30e, 30j, 30o) questionnaire items as all “tapping into” the same factor. ‘Referent power’ (questions 30e, 30j, 30o) has therefore been measured by calculating the mean of questionnaire items 30e, 30j and 30o. These three variables yielded an acceptable Cronbach Alpha reliability statistic of .756.

### 13.3.11 Degree of association between power dimensions and holistic locus of power question (Question 31)

Table 13.39 presents a correlation coefficient matrix comprising the five bases of power measures just described, and the holistic locus of power measure (question 31). Question 31 asked the respondent “In terms of influencing the hotel’s objectives/goals, which is more powerful?” A seven point Likert scale was used with 1 being ‘the operator’, 4 being ‘both equally’, and 7 being ‘the owner’. The Table highlights that all items are highly statistically significantly correlated at \(p < .01\). The fact that all five power dimensions are statistically significantly correlated with one another as well as with the holistic power question posed in question 31, gives a high degree of confidence in the five dimensions of power derived through factor analysis. For this reason, the decision has been made to use the holistic question (question 31) as the primary measure of power in all statistical analysis. Separate regression analyses will be run, however, that systematically use each of the five bases of power. A footnote will be provided of the results derived from these regression analyses, when they yield a significant result.
### TABLE 13.39
Correlations for ‘bases of power’ and the holistic power item (question 31)

<table>
<thead>
<tr>
<th></th>
<th>Reward power</th>
<th>Coercive power</th>
<th>Legitimate power</th>
<th>Expert power</th>
<th>Referent power</th>
<th>Holistic power (Q31)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reward power</td>
<td>1.000</td>
<td>.267**</td>
<td>.650**</td>
<td>.623**</td>
<td>.577**</td>
<td>.518**</td>
</tr>
<tr>
<td>Coercive power</td>
<td>.267**</td>
<td>1.000</td>
<td>.442**</td>
<td>.277**</td>
<td>.335**</td>
<td>.252**</td>
</tr>
<tr>
<td>Legitimate power</td>
<td>.650**</td>
<td>.442**</td>
<td>1.000</td>
<td>.667**</td>
<td>.746**</td>
<td>.627**</td>
</tr>
<tr>
<td>Expert power</td>
<td>.623**</td>
<td>.277**</td>
<td>.667**</td>
<td>1.000</td>
<td>.666**</td>
<td>.617**</td>
</tr>
<tr>
<td>Referent power</td>
<td>.577**</td>
<td>.335**</td>
<td>.746**</td>
<td>.666**</td>
<td>1.000</td>
<td>.499**</td>
</tr>
<tr>
<td>Holistic power (Q31)</td>
<td>.518**</td>
<td>.252**</td>
<td>.627**</td>
<td>.617**</td>
<td>.499**</td>
<td>1.000</td>
</tr>
</tbody>
</table>

**. Correlation is significant at the 0.01 level (2-tailed).

### 13.4 Conclusion

This chapter has provided an analysis of those variables that will be used in proposition testing and have been measured using several items. Where appropriate, any underlying dimensions were identified. The next chapter describes the results of statistically testing each of the twenty-three propositions developed in connection with the seven models described earlier in Chapter 10.
CHAPTER 14
STATISTICAL ANALYSIS AND PROPOSITION TESTING

14.1 Introduction

The objective of this chapter is to describe the results of statistically testing each of the twenty-three propositions outlined in Chapter 10. The main form of multivariate analysis used to test the models is multiple regression. Where a categorical dependent variable is under examination (e.g., model 2), logistic regression has been used. As hotel size in terms of number of rooms is an important underlying factor affecting the nature of hotel operations and management (see e.g. Garcia-Falcon & Medina-Munoz, 1999; Vallen & Vallen, 2005), it was felt prudent to include it as a control variable in the regression equations for models 1 through 4. In models 5, 6 and 7, hotel size serves as an independent variable.

The remainder of this chapter is structured as follows. The next section provides an overview of the underlying assumptions of regression analysis and the extent to which these are satisfied in the analysis undertaken. Following this, the chapter is structured sequentially according to the testing of the numbered propositions relating to the seven separate models. The final section provides a concluding commentary for the chapter.

14.2 Underlying assumptions of regression analysis

Regression equations require that conditions relating to multicollinearity; multivariate outliers; linearity and homoscedasticity; and normality are met. A brief overview of the nature of these conditions is now provided along with the results of tests concerned with appraising the extent to which the conditions have been satisfied.

14.2.1 Multicollinearity

Tabachnick and Fidell (2007) explain that multicollinearity is a situation in which the intercorrelations between variables are so high that certain statistical analyses cannot be performed. The presence of multicollinearity in a data set suggests that two or more separate

\[ \text{A discussion concerning normality for each of the questionnaire variables was provided in Chapter 12. It was noted that all the questionnaire variables could be treated as normal.} \]
independent variables are measuring the same thing. Tolerance and variance inflation factors are two statistical measures that are commonly suggested to determine the amount of multicollinearity between variables in a multiple regression equation. A tolerance level less than 0.1, or a variance inflation factor greater than 10 can signify the presence of multicollinearity. The results of these tests revealed that in all multiple regression models, multicollinearity was not a problem.²

14.2.2 Multivariate outliers

A multivariate outlier is a case that has a strange combination of scores on two or more variables. The Mahalanobis $D^2$ value can be calculated to provide an assessment of the position of each observation compared with the centre of all observations on a set of variables (Hair, et al., 2006). A conservative level of $p < 0.001$ is typically used as the critical outlier identification threshold (Tabachnick & Fidell, 2007). Using this criterion, no multivariate outliers were found in models 1, 3 or 4. Five multivariate outliers were detected in models 5, 6 and 7. Given the size of the data file, however, it is not unusual for a few outliers to appear, so in line with the recommendations of Tabachnick and Fidell (2007), and given that the five multivariate outliers did not greatly exceed the critical value, it was decided to retain these cases.³ Additional support for this approach was derived from calculation of Cook’s distance, which is another common statistical measure used to identify multivariate outliers. Cook’s distance measures the influence of observations in a data set by considering the impact of changes in predicted values when a case is omitted as well as the distance of the observation from all other observations (Tabachnick & Fidell, 2007). According to Hair et al. (2006), the rule of thumb for influential observations is a Cook’s distance value greater than 1.0. Calculation of Cook’s distances for all multiple regression models identified no multivariate outliers.

14.2.3 Linearity and homoscedasticity

According to Tabachnick and Fidell (2007), where regression analysis is carried out, problems with linearity and homoscedasticity are typically assessed by inspection of residual

² Note that there is no formal way to check for multicollinearity in a logistic regression (Pallant, 2007).
³ Model 2 is not discussed because there is no formal way to check for multivariate outliers in a logistic regression (Pallant, 2007).
plots. In residual plots, linearity is indicated where most of the residuals are concentrated in the centre along the zero point. Homoscedasticity is apparent where there is no clear or systematic pattern to the residuals. A rough rectangular distribution of residuals is therefore required to satisfy the criterion of linearity and homoscedasticity. Inspection of the residual plots for all seven regression models was conducted in the company of a resident expert statistician from Griffith University. No nonlinear or heteroscedastic residuals were detected.

14.3 Regression findings model 1: Length of hotel management contract

Table 14.1 presents the results of a multiple regression analysis of model 1, which is based on the following equation:

\[ Y = b_1 + b_2 \text{Holisticpower} + b_3 \text{Hotelsizerooms} + e \]

where:

- \( Y \) = Length of hotel management contract
- \( \text{Holisticpower} \) = Holistic locus of power (proposition 1)
- \( \text{Hotelsizerooms} \) = Size of hotel in number of rooms (control variable)

As explained in Chapter 12 a philosophy of minimising modification of data has been adhered to. With regard to the treatment of missing data, there are essentially two options: listwise or pairwise deletion. According to Pallant (2007), with listwise deletion, only cases that have full data on all variables are included in the regression equation. A case is therefore totally excluded from the analysis if it is missing only one piece of information, which can severely, and unnecessarily, limit the sample size. To avoid abandoning a large quantity of data, pairwise deletion has been adopted in this and all subsequent regression analyses, so that a case is only removed from the analysis if it is missing the data required for the specific analysis. In other words, all available data is included.

As explained in Chapter 13, as all five dimensions of power (i.e. reward, coercive, legitimate, expert, and referent) were statistically significantly correlated at \( p < .01 \) with holistic power. It was decided that holistic power be used as the primary measure of power in all statistical analyses. Separate regression analyses will be run, however, that systematically use each of the five dimensions of power, and a footnote will be made of the results derived from these regression analyses where they yield any significant results.

Where hotel size in number of rooms is a control variable, there is no directional expectation, so statistical significance will be determined via a two-tailed test.

---

4 As explained in Chapter 12 a philosophy of minimising modification of data has been adhered to. With regard to the treatment of missing data, there are essentially two options: listwise or pairwise deletion. According to Pallant (2007), with listwise deletion, only cases that have full data on all variables are included in the regression equation. A case is therefore totally excluded from the analysis if it is missing only one piece of information, which can severely, and unnecessarily, limit the sample size. To avoid abandoning a large quantity of data, pairwise deletion has been adopted in this and all subsequent regression analyses, so that a case is only removed from the analysis if it is missing the data required for the specific analysis. In other words, all available data is included.

5 As explained in Chapter 13, as all five dimensions of power (i.e. reward, coercive, legitimate, expert, and referent) were statistically significantly correlated at \( p < .01 \) with holistic power. It was decided that holistic power be used as the primary measure of power in all statistical analyses. Separate regression analyses will be run, however, that systematically use each of the five dimensions of power, and a footnote will be made of the results derived from these regression analyses where they yield any significant results.

6 Where hotel size in number of rooms is a control variable, there is no directional expectation, so statistical significance will be determined via a two-tailed test.
<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient(^a)</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>11.531</td>
<td>1.929</td>
<td>5.977</td>
<td>.000</td>
</tr>
<tr>
<td>Holistic power</td>
<td>-.098</td>
<td>.485</td>
<td>-.903</td>
<td>.184†</td>
</tr>
<tr>
<td>Hotelsize rooms</td>
<td>.257</td>
<td>.006</td>
<td>2.377</td>
<td>.020‡**</td>
</tr>
</tbody>
</table>

\[ R = .262 \]
\[ R^2 = .069 \]
\[ \text{Adjusted } R^2 = .046 \]
\[ F \text{ Ratio} = 2.996, \; p = .056‡*** \]

Notes:
† One-tailed test.
‡ Two-tailed test.
** Significant (p < .05) two-tailed test.
*** Significant (p < .1) two-tailed test.

\(^a\) Each cell represents the standardised regression coefficient (beta\(^7\)) except for the constant which is B.\(^8\) All subsequent tables reporting multiple regression findings follow this approach.

To test the goodness of fit of the linear model to the population, adjusted \( R^2 \) should be used (Tabachnick & Fidell, 2007).\(^9\) The adjusted \( R^2 \) value in this regression model is .046, which signifies that 4.6% of the dependent variable’s variance is explained by the independent and control variables. The model is statistically significant (\( F = 2.996, \; p < .1 \)).\(^10\) Bryman and Cramer (1990) recommend a test of statistical significance of individual regression coefficients through the calculation of a t-value for each co-efficient and an associated two-tailed significance test. The results of this testing are discussed below.

While the direction of the relationship was as expected (i.e. negative), no statistically significant relationship was found between holistic power and length of hotel management contract (\( p = .184 \); one-tailed test). This signifies that proposition 1 (owners with more power are able to negotiate relatively short management contracts) is not supported.\(^11\)

---

\(^7\) According to Norusis (1993), the beta coefficient is the slope of the least squares line where both x and y are expressed as z scores.

\(^8\) Use of standardised coefficients (as opposed to unstandardised coefficients) is recommended as the values for each of the different variables are converted to the same scale, which means that they can be directly compared (Hair, et al., 2006).

\(^9\) The smaller the sample size, the greater the variability of \( R^2 \), which can result in an overstatement of \( R^2 \). In small samples, it is therefore advisable to use adjusted \( R^2 \). If the sample size is large, adjusted \( R^2 \) will be similar to \( R^2 \) (Tabachnick & Fidell, 2007).

\(^10\) The F ratio expresses the correlation between the dependent variable and all of the independent variables collectively. It is useful as a test of statistical significance as a whole since \( R \) reflects how well the independent variables collectively correlate with the dependent variable (Bryman & Cramer, 1990).

\(^11\) Further regression models were run where holistic power was replaced with each of the five dimensions of power (i.e. reward, coercive, legitimate, expert, and referent). None of the five power dimensions were statistically significantly associated with hotel management contract length.
A positive statistically significant relationship was found between the hotel size control variable and length of hotel management contract \((p < .05;\) two-tailed test), which signifies that as hotel size increases, hotel management contracts tend to become longer.

### 14.4 Regression findings model 2: FF&E reserve accounting approach applied

As the dependent variable in model 2 is categorical (i.e. FF&E reserve accounting approach applied), a logistic regression model has been formulated (the dependent variable has two categories: cash and notional). Setting the dependent variable to one for cash and zero for notional, the logistic regression model can be written as follows:

\[
\log \left[ \frac{p}{1 - p} \right] = a + b \text{ (cash FF&E approach)},
\]

where “\(p\)” is the possibility that the dependent variable equals one, i.e., the cash FF&E reserve accounting approach is applied. As already noted, hotel size was included in the logistic regression model as a control variable. The Omnibus Test of Model Coefficients gives an indication of how well the model performs, i.e., a ‘goodness of fit’ test (Pallant, 2007). This two-tailed test indicates that the model is statistically significant, \(\chi^2 (2, n = 85) = 5.707, p < .1\). Further support for the merit of the model is evident from the Hosmer-Lemeshow Goodness of Fit Test, where poor fit is indicated by a significance value less than 0.1. The result of this test indicates that the model is statistically significant \(\chi^2 (7, n = 85) = 1.204, p > .1\). Inspection of the Cox & Snell R Square and the Nagelkerke R Square values provide an indication of the amount of variation in the dependent variable explained by the model (Pallant, 2007). These tests suggest that between 6.5% and 8.8% of the variability of the dependent variable is explained by the independent and control variables (Pallant, 2007). Table 14.2 presents the results of the logistic regression analysis.

---

Note that question 23, which determined the FF&E reserve accounting approach applied enabled four categorical responses: (1) cash; (2) notional; (3) no FF&E reserve; and (4) other. Only the cash and notional (non-cash) categories, however, are required for testing proposition 2, as it concerns whether locus of power affects choice of cash versus notional (non-cash) FF&E reserve accounting.
### TABLE 14.2
Results of logistic regression – Model 2

<table>
<thead>
<tr>
<th>Dependent variable: Type of FF&amp;E reserve accounting approach applied</th>
<th>Coefficient (B)</th>
<th>Standard error</th>
<th>Wald</th>
<th>df</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>1.868</td>
<td>.711</td>
<td>6.892</td>
<td>1</td>
<td>.009</td>
</tr>
<tr>
<td>Holisticpower</td>
<td>-.192</td>
<td>.158</td>
<td>1.471</td>
<td>1</td>
<td>.112†</td>
</tr>
<tr>
<td>Hotelsizerooms</td>
<td>-.004</td>
<td>.002</td>
<td>3.452</td>
<td>1</td>
<td>.063‡**</td>
</tr>
</tbody>
</table>

Notes:
† One-tailed test.
‡ Two-tailed test.
** Significant (p < 0.1) two-tailed test.

The individual results of the logistic regression analysis indicate that while the direction of the relationship was as expected (i.e. negative), no statistically significant relationship (p = .112; one-tailed test) was found between holistic power and application of the cash FF&E reserve accounting approach, which signifies that proposition 2 (owner dominated management contract hotels make low use of cash funded FF&E reserves) is not supported.13

A statistically significant negative relationship (p < .1; two-tailed test) was found between the hotel size control variable and the FF&E reserve accounting approach applied, which signifies that as hotel size increases, there is a decrease in the use of the cash FF&E reserve accounting approach.

### 14.5 Regression findings model 3: Adequacy of funds allocated to the FF&E reserve account

Table 14.3 presents the results of a multiple regression analysis of Model 3, which is based on the following equation:

\[ Y = b_1 + b_2 \text{Holisticpower} + b_3 \text{Agehotel} + b_4 \text{Hotelsizerooms} + e \]

where:

- \( Y \) = Adequacy of funds allocated to the FF&E reserve account
- Holisticpower = Holistic locus of power (proposition 3a)
- Agehotel = Age of hotel property (proposition 3b)
- Hotel size rooms = Size of hotel in number of rooms (control variable)

---

13 None of the five power dimensional measures were found to be statistically significantly associated with the FF&E reserve accounting approach applied.
TABLE 14.3
Results of multiple regression analysis – Model 3

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-2.713</td>
<td>.597</td>
<td>-4.549</td>
<td>.000</td>
</tr>
<tr>
<td>Holistic power</td>
<td>-.023</td>
<td>.141</td>
<td>-.188</td>
<td>.425†</td>
</tr>
<tr>
<td>Agehotel</td>
<td>.121</td>
<td>.009</td>
<td>.989</td>
<td>.326‡</td>
</tr>
<tr>
<td>Hotelsizerooms</td>
<td>.171</td>
<td>.002</td>
<td>1.383</td>
<td>.171‡</td>
</tr>
<tr>
<td>R</td>
<td>.197</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R²</td>
<td>.039</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>.006</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F Ratio</td>
<td>.874, p = .459‡</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes:
† One-tailed test.
‡ Two-tailed test.

The adjusted R² reveals that 0.6% of the variation of the dependent variable ‘adequacy of funds allocated to the FF&E reserve account’ is explained by the independent and control variables. The model is not statistically significant (F = .874, p = .459).

While the direction of the relationship was as expected (i.e. negative), no statistically significant relationship was found between holistic power and the adequacy of funds allocated to the FF&E reserve account (p = .425; one-tailed test), which signifies that proposition 3a (owner dominated management contract hotels make lower allocations to FF&E reserve accounts) is not supported.

The direction of the relationship (i.e. positive) was not as expected and no statistically significant relationship was found between age of hotel property and the adequacy of funds allocated to the FF&E reserve account (p = .326; two-tailed test), which signifies that proposition 3b (FF&E reserve allocations are viewed as more inadequate in older hotel properties) is not supported.

No statistically significant relationship was found between hotel size and the adequacy of funds allocated to the FF&E reserve account (p = .171; two-tailed test).

---

14 None of the five power dimensional measures were found to be statistically significantly associated with the FF&E reserve accounting approach applied.
14.6 Regression findings model 4: Hotel owner propensity to release FF&E reserve account funds

Table 14.4 presents the results of a multiple regression analysis of Model 4, which is based on the following equation:

\[ Y = b_1 + b_2 \text{Holisticpower} + b_3 \text{Egotrip} + b_4 \text{Hotelsizerooms} + e \]

where:

- \( Y \) = Hotel owner propensity to release FF&E reserve account funds
- \( \text{Holisticpower} \) = Holistic locus of power (proposition 4a)
- \( \text{Egotrip} \) = Ego trip ownership (proposition 4b)
- \( \text{Hotelsizerooms} \) = Hotel size in number of rooms (control variable)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>4.074</td>
<td>.784</td>
<td>5.195</td>
<td>.000</td>
</tr>
<tr>
<td>Holisticpower</td>
<td>-.077</td>
<td>.113</td>
<td>-.704</td>
<td>.241†</td>
</tr>
<tr>
<td>Egotrip</td>
<td>-.044</td>
<td>.164</td>
<td>-.399</td>
<td>.691‡</td>
</tr>
<tr>
<td>Hotelsizerooms</td>
<td>-.207</td>
<td>.001</td>
<td>-1.885</td>
<td>.063‡**</td>
</tr>
</tbody>
</table>

\[ R = .230 \]
\[ R^2 = .053 \]
\[ \text{Adjusted } R^2 = .018 \]
\[ F \text{ Ratio} = 1.528, p = .213‡ \]

Notes:
- † One-tailed test.
- ‡ Two-tailed test.
- ** Significant \((p < 0.1)\) two-tailed

The adjusted \( R^2 \) reveals that 1.8% of the variation of hotel owner’s propensity to release FF&E reserve account funds is explained by the independent and control variables. The model is not statistically significant (\( F = 1.528, p = .213 \)).

While the direction of the relationship was as expected (i.e. negative), no statistically significant relationship was found between holistic power and hotel owner propensity to release FF&E reserve account funds \((p = .241; \text{one-tailed test})\), signifying that proposition 4a...
“there is a lower propensity for the hotel owner to release FF&E reserve funds in owner dominated hotels”) is not supported.\textsuperscript{15}

No statistically significant relationship was found between ego-trip ownership and the hotel owner propensity to release FF&E reserve account funds \((p = .691; \text{ two tailed test})\). This signifies that proposition 4b (“ego-trip owners are more likely to make the release of FF&E reserve funds easy”) is not supported.

A negative statistically significantly relationship was found between hotel size and hotel owner propensity to release FF&E reserve account funds \((p < .1; \text{ two-tailed test})\), signifying that as hotel size decreases, hotel owners tend to release FF&E reserve funds.

\textbf{14.7 Regression findings model 5: Sophisticated quantitative capital budgeting technique usage}

In Model 5, the independent variables ‘hotel operating with a management contract’ and ‘public vs. private owner’ are categorical variables, which means that dummy variables have to be generated (Tabachnick & Fidell, 2007).\textsuperscript{16} With regard to the ‘hotel operating with a management contract’ variable, following the ‘\(k - 1\)’ standard formula for dummy variables (where \(k\) is equal to the number of categories comprising the variable), as this variable comprised four categories, three dummy variables were created for the responses of ‘management contract’, ‘franchise’ and ‘independent owner-operator’. The fourth ‘other’ category was the one excluded. For each of the three dummy variables, where a respondent answered in the affirmative for the particular category, the response was coded as 1 and all other responses as 0. Testing of propositions in connection with this variable involved an inspection for the statistical significance of the management contract dummy variable. With regard to the independent variable ‘public vs. private hotel owner’, a response indicating public ownership was coded as 1 and private was coded as 0.

\textsuperscript{15} Further regression models were run where holistic power was replaced with each of the five dimensions of power (i.e. reward, coercive, legitimate, expert, and referent). An unexpected positive relationship was found between coercive power and hotel owner propensity to release FF&E reserve account funds, which was statistically significant \((p < .01; \text{ two-tailed test})\). None of the other four power measures yielded a statistically significant association with adequacy of funds allocated to the FF&E reserve account.

\textsuperscript{16} Where the same categorical variables are used in models 6 and 7, the same explanation as that outlined here applies.
As indicated earlier, for the purposes of proposition testing, it was thought appropriate to develop two measures of the relative usage of sophisticated quantitative capital budgeting techniques. Both measures represent an ‘index of sophistication’ but the first is a ‘single item’ index of sophistication, calculated as NPV use – payback use. The second is a ‘multiple item’ index of sophistication, calculated as ((NPV use + IRR use) – (Payback use + AARR use)).

### 14.7.1 Model 5 regression findings using single item index of sophistication

Table 14.5 presents the results of a multiple regression analysis of Model 5 using the ‘single item’ index of sophistication, which is based on the following equation:

\[
Y = b_1 + b_2 \text{Mancontractdummy} + b_3 \text{Franchisedummy} + b_4 \text{Independentdummy} + b_5 \text{Ownerinvolve} + b_6 \text{Sizeownerhotels} + b_7 \text{Publicdummy} + b_8 \text{Sizehotelrooms} + e
\]

where:

- \(Y\) = Single item index of sophisticated quantitative capital budgeting technique usage
- \text{Mancontractdummy} = Management contract dummy variable (proposition 5a)
- \text{Franchisedummy} = Franchise dummy variable
- \text{Independentdummy} = Independent owner-operator dummy variable
- \text{Ownerinvolve} = Owner involvement in the capital budgeting process (proposition 5b)
- \text{Sizeownerhotels} = Number of hotels owned by owner (proposition 5c)
- \text{Publicdummy} = Public dummy variable (proposition 5d)
- \text{Sizehotelrooms} = Size of hotel property in terms of number of rooms (proposition 5e)
TABLE 14.5
Results of multiple regression analysis – Model 5
Dependent variable: Single item index of sophisticated quantitative capital budgeting
technique usage

‘Ownerinvolv’ had missing correlations and was deleted from the analysis.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>.146</td>
<td>.841</td>
<td>.174</td>
<td>.862</td>
</tr>
<tr>
<td>Mancontractdummy</td>
<td>-.333</td>
<td>.813</td>
<td>-1.542</td>
<td>.125‡</td>
</tr>
<tr>
<td>Franchisedummy</td>
<td>-.086</td>
<td>.931</td>
<td>-.607</td>
<td>.545</td>
</tr>
<tr>
<td>Independentdummy</td>
<td>-.340</td>
<td>.820</td>
<td>-1.615</td>
<td>.108</td>
</tr>
<tr>
<td>Publicdummy</td>
<td>.066</td>
<td>.340</td>
<td>.800</td>
<td>.212†</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>-.009</td>
<td>.001</td>
<td>-.111</td>
<td>.912‡</td>
</tr>
</tbody>
</table>

R = .186
R² = .034
Adjusted R² = .001
F Ratio = 1.034, p = .405‡

Notes:
† One-tailed test.
‡ Two-tailed test.

The adjusted R² reveals that 0.1% of the variation of the dependent variable single item index of sophisticated quantitative capital budgeting technique usage is explained by the independent variables. The model is not statistically significant (F = 1.034, p = .405). The individual results of the regression analyses are presented below.

The direction of the relationship (i.e. negative) was not as expected and no statistically significant relationship was found between the management contract dummy variable and the single item index of sophisticated quantitative capital budgeting technique usage (p = .125; two-tailed test). This signifies that proposition 5a (hotels with management contracts make greater use of sophisticated quantitative capital budgeting techniques) is not supported.

The regression model deleted ‘hotel owner involvement in the capital budgeting process’ because it was a constant or had missing correlations. As explained by Field (2009), variables are deleted from a regression equation where their t-statistic value is less than .05 because they do not make any significant contribution to the model. This means that it was not possible to directly test proposition 5b (greater hotel owner involvement in the capital budgeting process leads to a reduced use of sophisticated quantitative capital budgeting techniques). The possibility of running a separate regression analysis using only hotel owner involvement in the capital budgeting process and the control variable ‘hotel size’ as independent variables and the single item index ‘sophisticated quantitative capital budgeting
technique usage’ as the dependent variable was considered.\(^{17}\) The model satisfied tests for
multicollinearity; multivariate outliers; linearity and homoscedasticity; and normality. Table
14.6 presents the results of this multiple regression analysis, which is based on the following
equation:

\[ Y = b_1 + b_2 \text{Ownerinvolve} + b_3 \text{Sizehotelrooms} + e \]

where:

\[ Y = \text{Single item index of sophisticated quantitative capital budgeting technique usage} \]
\[ \text{Ownerinvolve} = \text{Owner involvement in the capital budgeting process (proposition 5b)} \]
\[ \text{Sizehotelrooms} = \text{Size of hotel property in terms of number of rooms (control variable)} \]

| TABLE 14.6 |
| Results of multiple regression analysis for proposition 5b |

<table>
<thead>
<tr>
<th>Dependent variable: Single item index of sophisticated quantitative capital budgeting technique usage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable</td>
</tr>
<tr>
<td>Constant</td>
</tr>
<tr>
<td>Ownerinvolve</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
</tr>
</tbody>
</table>

| R | .137 |
| R\(^2\) | .019 |
| Adjusted R\(^2\) | .001 |
| F Ratio | .938, p = .395‡ |

Notes:

† One-tailed test.
‡ Two-tailed test.
* Significant (p < 0.1) one-tailed

The adjusted R\(^2\) reveals that 0.1% of the variation of the dependent variable single item index
of sophisticated quantitative capital budgeting technique usage is explained by the
independent variables. The model is not statistically significant (F = .938, p = .395). The
individual results of the separate regression equation indicate that the direction of the
relationship (i.e. negative) was as expected and a statistically significant relationship was
found between hotel owner involvement in the capital budgeting process and the single item
index of sophisticated quantitative capital budgeting technique usage (p < .1; one-tailed test),
which signifies that proposition 5b (greater hotel owner involvement in the capital budgeting

\(^{17}\) Although hotel size in number of rooms is an independent variable in Model 5, it was considered pertinent
and consistent to include it as a control variable in this separate regression equation.
process leads to a reduced use of sophisticated quantitative capital budgeting techniques is supported.

The direction of the relationship (i.e. negative) was not as expected and no statistically significant relationship was found between hotel owner size and the single item index of sophisticated quantitative capital budgeting technique usage ($p = .121$; two-tailed test). This signifies that proposition 5c (large owners make greater use of sophisticated quantitative capital budgeting techniques) is not supported.

The direction of the relationship was as expected (i.e. positive) but no statistically significant relationship was found between public vs. private hotel ownership and the single item index of sophisticated quantitative capital budgeting technique usage ($p = .212$; one-tailed test). This signifies that proposition 5d (public hotel owners make greater use of sophisticated quantitative capital budgeting techniques) is not supported.

The direction of the relationship (i.e. negative) was not as expected and no statistically significant relationship was found between hotel size and the single item index of sophisticated quantitative capital budgeting technique usage ($p = .912$; two-tailed test). This signifies that proposition 5e (large hotels make greater use of sophisticated quantitative capital budgeting techniques) is not supported.

14.7.2 Model 5 regression findings using multiple item index of sophistication

Table 14.7 presents the results of a multiple regression analysis of Model 5 using the ‘multiple item’ index of sophistication, which is based on the following equation:

$$Y = b_1 + b_2 \text{Mancontractdummy} + b_3 \text{Franchisedummy} + b_4 \text{Independentdummy} + b_5 \text{Ownerinvolve} + b_6 \text{Sizeownerhotels} + b_7 \text{Publicdummy} + b_8 \text{Sizehotelrooms} + e$$

where:

- $Y$ = Multiple item index of sophisticated quantitative capital budgeting technique use
- Mancontractdummy = Management contract dummy variable (proposition 5a)
- Franchisedummy = Franchise dummy variable
- Independentdummy = Independent owner-operator dummy variable
- Ownerinvolve = Owner involvement in the capital budgeting process (proposition 5b)
- Sizeownerhotels = Size of hotel owner in number of hotels owned (proposition 5c)
Publicdummy = Public dummy variable (proposition 5d)
Sizehotelrooms = Size of hotel property in terms of number of rooms (proposition 5e)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>.968</td>
<td>1.151</td>
<td>.841</td>
<td>.402</td>
</tr>
<tr>
<td>Mancontractdummy</td>
<td>-.436</td>
<td>1.112</td>
<td>-2.019</td>
<td>.045‡**</td>
</tr>
<tr>
<td>Franchisedummy</td>
<td>-.165</td>
<td>1.274</td>
<td>-1.164</td>
<td>.246</td>
</tr>
<tr>
<td>Independetdummy</td>
<td>-.415</td>
<td>1.122</td>
<td>-1.973</td>
<td>.050</td>
</tr>
<tr>
<td>Sizeownerhotels</td>
<td>-.084</td>
<td>.000</td>
<td>-1.022</td>
<td>.308‡</td>
</tr>
<tr>
<td>Publicdummy</td>
<td>.043</td>
<td>.465</td>
<td>.519</td>
<td>.302†</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>.071</td>
<td>.002</td>
<td>.896</td>
<td>.185†</td>
</tr>
<tr>
<td>R</td>
<td>.195</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R²</td>
<td>.038</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted R²</td>
<td>.005</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>F Ratio</td>
<td>1.142, p = .340‡</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes:
† One-tailed test.
‡ Two-tailed test.
** Significant (p < 0.05) two-tailed.

The adjusted R² reveals that 0.5% of the variation of dependent variable ‘multiple item index of sophisticated quantitative capital budgeting technique usage’ is explained by the independent variables. The model is not statistically significant (F = 1.142, p = .340).

The direction of the relationship (i.e. negative) was not as expected but a statistically significant relationship was found between the management contract dummy variable and the multiple item index of sophisticated quantitative capital budgeting technique usage (p < .05; two-tailed test). This suggests that hotels with management contracts use sophisticated quantitative capital budgeting techniques to a low degree.

The regression model deleted the independent variable ‘hotel owner involvement in the capital budgeting process’ because it was a constant or had missing correlations. As before, the viability of running a separate regression analysis using only hotel owner involvement in the capital budgeting process and the control variable ‘hotel size’ was explored. This model satisfied all associated tests for multicollinearity, multivariate outliers, linearity and
homoscedasticity; and normality. Table 14.8 presents the results of this multiple regression analysis, which is based on the following equation:

\[ Y = b_1 + b_2 \text{Ownerinvolve} + b_3 \text{Sizehotelrooms} + e \]

where:

\[ Y = \text{Multiple item index of sophisticated quantitative capital budgeting technique usage} \]

\[ \text{Ownerinvolve} = \text{Owner involvement in the capital budgeting process (proposition 5b)} \]

\[ \text{Sizehotelrooms} = \text{Size of hotel property in terms of number of rooms (control variable)} \]

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>-.283</td>
<td>1.280</td>
<td>-.221</td>
<td>.826</td>
</tr>
<tr>
<td>Ownerinvolve</td>
<td>-.076</td>
<td>.234</td>
<td>-.743</td>
<td>.229†</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>.098</td>
<td>.002</td>
<td>.951</td>
<td>.344‡</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>( R )^2</th>
<th>( R^2 )</th>
<th>Adjusted ( R^2 )</th>
<th>F Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes:</td>
<td>( .112 )</td>
<td>( .013 )</td>
<td>( .008 )</td>
<td>( .619, p = .541‡ )</td>
</tr>
</tbody>
</table>

The adjusted \( R^2 \) reveals that 0.8% of the variation of the dependent variable single item index of sophisticated quantitative capital budgeting technique usage is explained by the independent variables. The model is not statistically significant (\( F = .619, p = .541 \)). The result of the separate regression analyses indicated that the direction of the relationship (i.e. negative) was as expected but no statistically significant relationship was found between hotel owner involvement in the capital budgeting process and the multiple item index of sophisticated quantitative capital budgeting technique usage (\( p = .229; \) one-tailed test). This signifies that proposition 5b (greater hotel owner involvement in the capital budgeting process leads to a reduced use of sophisticated quantitative capital budgeting techniques) is not supported.

The direction of the relationship (i.e. negative) was not as expected and no statistically significant relationship was found between hotel owner size and the multiple item index of sophisticated quantitative capital budgeting technique usage (\( p = .308; \) two-tailed test). This
signifies that proposition 5c (large owners make greater use of sophisticated quantitative capital budgeting techniques) is not supported.

The direction of the relationship (i.e. positive) was as expected but no statistically significant relationship was found between public vs. private hotel ownership and the multiple item index of sophisticated quantitative capital budgeting technique usage ($p = .302$; one-tailed test). This signifies that proposition 5d (public hotel owners make greater use of sophisticated quantitative capital budgeting techniques) is not supported.

The direction of the relationship (i.e. positive) was as expected but no statistically significant relationship was found between size of hotel property and the multiple item index of sophisticated quantitative capital budgeting technique usage ($p = .185$; one-tailed test). This signifies that proposition 5e (large hotels make greater use of sophisticated quantitative capital budgeting techniques) is not supported.

14.8 Regression findings model 6: Emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal

As outlined in Chapter 13, the ‘index’ of the emphasis attached to quantitative versus qualitative investment appraisal factors was not significantly correlated with the ‘holistic’ measure of the emphasis attached to quantitative versus qualitative investment appraisal factors. It was therefore felt prudent to formulate separate regression models where the ‘index’ and the ‘holistic’ measures serve as dependent variables. The following sections describe the results of two separate multiple regression analyses focused on these two measures of emphasis attached to quantitative versus qualitative investment appraisal factors.

14.8.1 Model 6 regression findings using index of emphasis attached to quantitative relative to qualitative investment appraisal techniques

Table 14.9 presents the results of a multiple regression analysis of Model 6 using the index of emphasis attached to quantitative relative to qualitative investment appraisal techniques, which is based on the following equation:
\[ Y = b_1 + b_2 \text{Publicdummy} + b_3 \text{Mancontractdummy} + b_4 \text{Franchisedummy} + b_5 \text{Independentdummy} + b_6 \text{Sizeownerhotels} + b_7 \text{Holisticpower} + b_8 \text{Ownerinvolve} + b_9 \text{Sizehotelrooms} + \epsilon \]

where:

\[ Y = \text{Index of emphasis attached to quantitative vs. qualitative investment appraisal} \]
\[ \text{Publicdummy} = \text{Public dummy variable (proposition 6a)} \]
\[ \text{Mancontractdummy} = \text{Management contract dummy variable (proposition 6b)} \]
\[ \text{Franchisedummy} = \text{Franchise contract dummy variable} \]
\[ \text{Independentdummy} = \text{Independent dummy variable} \]
\[ \text{Sizeownerhotels} = \text{Size of hotel owner in number of hotels owned (proposition 6c)} \]
\[ \text{Holisticpower} = \text{Holistic locus of power (proposition 6d)} \]
\[ \text{Ownerinvolve} = \text{Owner involvement in the capital budgeting process (proposition 6e)} \]
\[ \text{Sizehotelrooms} = \text{Size of hotel property in terms of number of rooms (proposition 6f)} \]

**TABLE 14.9**

Results of multiple regression analysis – Model 6

**Dependent variable: Index of emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal**


<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>1.449</td>
<td>.624</td>
<td>2.321</td>
<td>.021</td>
</tr>
<tr>
<td>Publicdummy</td>
<td>.076</td>
<td>.252</td>
<td>.939</td>
<td>.174†</td>
</tr>
<tr>
<td>Mancontractdummy</td>
<td>.088</td>
<td>.603</td>
<td>.415</td>
<td>.339†</td>
</tr>
<tr>
<td>Franchisedummy</td>
<td>-.044</td>
<td>.691</td>
<td>-.318</td>
<td>.751</td>
</tr>
<tr>
<td>Independentdummy</td>
<td>-.046</td>
<td>.608</td>
<td>-.223</td>
<td>.824</td>
</tr>
<tr>
<td>Sizeownerhotels</td>
<td>-.120</td>
<td>.000</td>
<td>-1.481</td>
<td>.141‡</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>.186</td>
<td>.001</td>
<td>2.402</td>
<td>.008‡*</td>
</tr>
</tbody>
</table>

| R                  | .299         |
| R^2                | .089         |
| Adjusted R^2       | .057         |
| F Ratio            | 2.778, \( p = .013^{‡*} \)*** |

Notes:

† One-tailed test.
‡ Two-tailed test.
* Significant \( (p < .01) \) one-tailed.
** Significant \( (p < .05) \) two-tailed.

The adjusted \( R^2 \) reveals that 5.7% of the variance of the dependent variable ‘emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques’ is explained by the independent variables. The model is statistically significant \( (F = 2.778, p = < .05) \).
The direction of the relationship (i.e. positive) was as expected but no statistically significant relationship was found between public vs. private hotel ownership and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques ($p = .174$; one-tailed test). This signifies that proposition 6a (relative to private hotel owners, public hotel owners make greater use of quantitative techniques in investment appraisal) is not supported.

The direction of the relationship (i.e. positive) was as expected, but no statistically significant relationship was found between the management contract dummy variable and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques ($p = .339$; one-tailed test). This signifies that proposition 6b (hotels operating with a management contract make greater use of quantitative techniques in investment appraisal than non-management contract hotels) is not supported.

The direction of the relationship (i.e. negative) was not as expected and no statistically significant relationship was found between size of hotel owner and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques ($p = .141$; two-tailed test). This signifies that proposition 6c (in hotels that are owned by large hotel owners, greater emphasis is attached to quantitative techniques in investment appraisal) is not supported.

The regression model deleted the holistic power independent variable because it was a constant or had missing correlations. This means that it was not possible to directly test proposition 6d (dominant hotel owners will require a high emphasis on quantitative techniques in investment appraisal). The possibility of running a separate regression analysis using only holistic power and the control variable of hotel size as the independent variables and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques as the dependent variable was explored and the model satisfied assessments for multicollinearity; multivariate outliers; and linearity and homoscedasticity. Table 14.10 presents the results of the multiple regression analysis using the index of emphasis attached to quantitative relative to qualitative investment appraisal techniques, which is based on the following equation:

$$Y = b_1 + b_2 \text{ Holisticpower} + b_3 \text{ Sizehotelrooms} + e$$

where:

- $Y = \text{Index of emphasis attached to quantitative vs. qualitative investment appraisal}$
Holisticpower = Holistic locus of power (proposition 6d)
Sizehotelrooms = Size of hotel property in terms of number of rooms (control variable)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>1.488</td>
<td>.373</td>
<td>3.986</td>
<td>.000</td>
</tr>
<tr>
<td>Holisticpower</td>
<td>-.027</td>
<td>.094</td>
<td>-.271</td>
<td>.787‡</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>.239</td>
<td>.001</td>
<td>2.372</td>
<td>.020‡**</td>
</tr>
</tbody>
</table>

R = .237
R² = .056
Adjusted R² = .036
F Ratio = 2.815, \( p = .065^{‡***} \)

Notes:
† One-tailed test.
‡ Two-tailed test.
** Significant (\( p < .05 \)) two-tailed.
*** Significant (\( p < .1 \)) two-tailed.

The adjusted \( R^2 \) reveals that 3.6% of the variance of the dependent variable ‘emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques’ is explained by the independent variables. The model is statistically significant (F = 2.815, \( p = < .1 \)). The result of this separate regression analyses indicates that the direction of the relationship (i.e. negative) was not as expected and there was no statistically significant relationship found between holistic power and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques (\( p = .787 \); two-tailed test), signifying that proposition 6d is not supported.\(^{18}\)

The regression model deleted the independent variable of hotel owner involvement in the capital budgeting process because it was a constant or had missing correlations. The possibility of running a separate regression analysis using only the hotel owner involvement in the capital budgeting process and the control variable ‘hotel size’ as independent variables and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques as the dependent variable was explored and the model satisfied assessments for

\(^{18}\) Further regression models were run where holistic power was replaced with each of the five dimensions of power (i.e. reward, coercive, legitimate, expert, and referent). A positive (as expected) statistically significant relationship was found between referent power (\( p < .1; \) one-tailed test) and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques. None of the other four power measures were found to be statistically significantly associated with the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques.
multicollinearity; multivariate outliers; and linearity and homoscedasticity. Table 14.11 presents the results of this multiple regression analysis using the index of emphasis attached to quantitative relative to qualitative investment appraisal techniques, which is based on the following equation:

\[ Y = b_1 + b_2 \text{ Ownerinvolve} + b_3 \text{ Sizehotelrooms} + e \]

where:

- \( Y \) = Index of emphasis attached to quantitative vs. qualitative investment appraisal
- \( \text{Ownerinvolve} \) = Owner involvement in the capital budgeting process (proposition 6e)
- \( \text{Sizehotelrooms} \) = Size of hotel property in terms of number of rooms (control variable)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>.079</td>
<td>.678</td>
<td>.116</td>
<td>.908</td>
</tr>
<tr>
<td>Ownerinvolve</td>
<td>.209</td>
<td>.124</td>
<td>2.120</td>
<td>.018†*</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>.196</td>
<td>.001</td>
<td>1.989</td>
<td>.049‡**</td>
</tr>
</tbody>
</table>

| R                  | .312         |
| R\(^2\)            | .097         |
| Adjusted R\(^2\)   | .079         |
| F Ratio            | 5.184, \(p = .007‡***\) |

Notes:
† One-tailed test.
‡ Two-tailed test.
* Significant \((p < .01)\) one-tailed.
** Significant \((p < .05)\) two-tailed.
*** Significant \((p < .01)\) two-tailed.

The adjusted \( R^2 \) reveals that 7.9% of the variance of the dependent variable ‘emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques’ is explained by the independent variables. The model is statistically significant \((F = 5.184, p = < .01)\). The result of this separate regression analysis revealed a positive (as expected) and a statistically significant relationship between hotel owner involvement in the capital budgeting process and the index of emphasis attached to quantitative vs. qualitative investment appraisal techniques \((p < .05;\) one-tailed test). This represents support for proposition 6e.

The direction of the relationship was as expected (i.e. positive) and a statistically significant relationship was found between size of hotel property and the index of emphasis attached to
quantitative vs. qualitative investment appraisal techniques \( (p < .01; \text{one-tailed test}) \). This signifies that proposition 6f (large hotels make greater use of quantitative techniques in investment appraisal) is supported.

### 14.8.2 Model 6 regression findings using holistic emphasis attached to quantitative relative to qualitative investment appraisal techniques

Table 14.12 presents the results of a multiple regression analysis of Model 6 using holistic emphasis attached to quantitative versus qualitative investment appraisal techniques. It is based on the following equation:

\[
Y = b_1 + b_2 \text{Publicdummy} + b_3 \text{Mancontractdummy} + b_4 \text{Franchisedummy} + b_5 \text{Independentdummy} + b_6 \text{Sizeownerhotels} + b_7 \text{Holisticpower} + b_8 \text{Ownerinvolve} + b_9 \text{Sizehotelrooms} + e
\]

where:
- \( Y \) = Holistic emphasis attached to quantitative vs. qualitative investment appraisal
- \( \text{Publicdummy} \) = Public dummy variable (proposition 6a)
- \( \text{Mancontractdummy} \) = Management contract dummy variable (proposition 6b)
- \( \text{Franchisedummy} \) = Franchise contract dummy variable
- \( \text{Independentdummy} \) = Independent dummy variable
- \( \text{Sizeownerhotels} \) = Size of hotel owner in number of hotels owned (proposition 6c)
- \( \text{Holisticpower} \) = Holistic locus of power (proposition 6d)
- \( \text{Ownerinvolve} \) = Owner involvement in the capital budgeting process (proposition 6e)
- \( \text{Sizehotelrooms} \) = Size of hotel property in terms of number of rooms (proposition 6f)
### TABLE 14.12
Results of multiple regression analysis – Model 6
Dependent variable: Holistic emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal

‘Holistic power’ and ‘ownerinvolve’ were identified as constants or have missing correlations. Accordingly they were deleted from the analysis.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>4.145</td>
<td>.638</td>
<td>6.492</td>
<td>.000</td>
</tr>
<tr>
<td>Publicdummy</td>
<td>.011</td>
<td>.258</td>
<td>.137</td>
<td>.455†</td>
</tr>
<tr>
<td>Mancontractdummy</td>
<td>.096</td>
<td>.617</td>
<td>.440</td>
<td>.330†</td>
</tr>
<tr>
<td>Franchiseedummy</td>
<td>.005</td>
<td>.707</td>
<td>.037</td>
<td>.970</td>
</tr>
<tr>
<td>Independentdummy</td>
<td>.148</td>
<td>.622</td>
<td>.696</td>
<td>.487</td>
</tr>
<tr>
<td>Sizeownerhotels</td>
<td>.050</td>
<td>.000</td>
<td>.595</td>
<td>.276†</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>.052</td>
<td>.001</td>
<td>.651</td>
<td>.258†</td>
</tr>
</tbody>
</table>

\[ R = .113 \]
\[ R^2 = .013 \]
\[ \text{Adjusted } R^2 = .021 \]
\[ F \text{ Ratio} = .374, p = .895‡ \]

Notes:
† One-tailed test.
‡ Two-tailed test.

The adjusted $R^2$ reveals that 2.1% of the variation of the dependent variable holistic emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques is explained by the independent variables. The model is not statistically significant ($F = .374, p = .895$).

The direction of the relationship (i.e. positive) was as expected but no statistically significant relationship was found between public vs. private hotel ownership and the holistic emphasis attached to quantitative vs. qualitative investment appraisal techniques ($p = .455$; one-tailed test). This signifies that proposition 6a (relative to private hotel owners, public hotel owners make greater use of quantitative techniques in investment appraisal) is not supported.

The direction of the relationship (i.e. positive) was as expected but no statistically significant relationship was found between the management contract dummy variable and the holistic emphasis attached to quantitative vs. qualitative investment appraisal techniques ($p = .330$; one-tailed test). This signifies that proposition 6b (hotels operating with a management contract make greater use of quantitative techniques in investment appraisal than non-management contract hotels) is not supported.

The direction of the relationship (i.e. positive) was as expected, but no statistically significant relationship was found between size of hotel owner and the holistic emphasis attached to
quantitative vs. qualitative investment appraisal techniques ($p = .276$; one-tailed test). This signifies that proposition 6c (in hotels that are owned by large hotel owners, greater emphasis is attached to quantitative techniques in investment appraisal) is not supported.

The regression model deleted the independent variable ‘holistic power’ because it was a constant or had missing correlations. The possibility of running a separate regression analysis using only holistic power and the control variable ‘hotel size’ as independent variables was explored. This model satisfied assessments for multicollinearity; multivariate outliers; and linearity and homoscedasticity. Table 14.13 presents the results of the multiple regression analysis, which is based on the following equation:

$$Y = b_1 + b_2 \text{Holistic power} + b_3 \text{Size hotel rooms} + e$$

where:

- $Y$ = Holistic emphasis attached to quantitative vs. qualitative investment appraisal
- Holistic power = Holistic locus of power (proposition 6d)
- Size hotel rooms = Size of hotel property in terms of number of rooms (control variable)

### Table 14.13

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>$p$-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>4.494</td>
<td>.380</td>
<td>11.834</td>
<td>.000</td>
</tr>
<tr>
<td>Holistic power</td>
<td>.002</td>
<td>.095</td>
<td>.021</td>
<td>.491†</td>
</tr>
<tr>
<td>Size hotel rooms</td>
<td>.041</td>
<td>.001</td>
<td>.401</td>
<td>.690‡</td>
</tr>
</tbody>
</table>

| R    | .042 |
| R²   | .002 |
| Adjusted R² | .019 |
| F Ratio | .083, $p = .920$‡ |

Notes:
- † One-tailed test.
- ‡ Two-tailed test.

The adjusted $R^2$ reveals that 1.9% of the variance of the dependent variable ‘emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques’ is explained by the independent variables. The model is not statistically significant ($F = .083, p = .920$).

The result of this separate regression equation indicated an expected positive relationship but there was no statistically significant relationship between holistic power and holistic
emphasis attached to quantitative vs. qualitative investment appraisal techniques ($p = .491$; one-tailed test), signifying that proposition 6d is not supported.\(^{19}\)

The regression model also deleted the independent variable ‘hotel owner involvement in the capital budgeting process’ because it was a constant or had missing correlations. The possibility of running a separate regression analysis using only hotel owner involvement in the capital budgeting process and hotel size as independent variables was explored. The model satisfied assessments of multicollinearity; multivariate outliers; and linearity and homoscedasticity. Table 14.14 presents the results of the multiple regression analysis, which is based on the following equation:

$$Y = b_1 + b_2 \text{Ownerinvolv} + b_3 \text{Sizehotelrooms} + e$$

where:

- $Y =$ Holistic emphasis attached to quantitative vs. qualitative investment appraisal
- $\text{Ownerinvolv} =$ Owner involvement in the capital budgeting process (proposition 6e)
- $\text{Sizehotelrooms} =$ Size of hotel property in terms of number of rooms (control variable)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>$p$-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>3.648</td>
<td>.699</td>
<td>5.222</td>
<td>.000</td>
</tr>
<tr>
<td>Ownerinvolv</td>
<td>.134</td>
<td>.127</td>
<td>1.311</td>
<td>.096†*</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>.017</td>
<td>.001</td>
<td>.163</td>
<td>.871‡</td>
</tr>
</tbody>
</table>

$R = .138$

$R^2 = .019$

Adjusted $R^2 = .001$

$F \text{ Ratio} = .944, p = .393\dagger$

Notes:

† One-tailed test.

‡ Two-tailed test.

* Significant ($p < .1$) one-tailed.

The adjusted $R^2$ reveals that 0.1% of the variance of the dependent variable ‘emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques’ is explained by the independent variables. The model is not statistically significant ($F = .944, p = .393$).

---

\(^{19}\) Further regression models were run where holistic power was replaced with each of the five dimensions of power (i.e. reward, coercive, legitimate, expert, and referent). None of these measures yielded a statistically significant association with holistic emphasis attached to quantitative vs. qualitative investment appraisal techniques.
The result of this separate regression equation indicated a statistically significant positive relationship association between hotel owner involvement in the capital budgeting process and holistic emphasis attached to quantitative vs. qualitative investment appraisal techniques \( (p < .1; \text{one-tailed test}) \), which signifies that proposition 6e is supported.

The direction of the relationship was as expected (i.e. positive), but no statistically significant relationship was found between size of hotel property and the holistic emphasis attached to quantitative vs. qualitative investment appraisal techniques \( (p = .258; \text{one-tailed test}) \). This signifies that proposition 6f (large hotels make greater use of quantitative techniques in investment appraisal) is not supported.

14.9 Regression findings model 7: Propensity of hotel management to positively bias capital budgeting proposals

Table 14.15 presents the results of a multiple regression analysis of Model 7, which is based on the following equation:

\[
Y = b_1 + b_2 \text{Mancontractdummy} + b_3 \text{Franchisedummy} + b_4 \text{Independentdummy} + b_5 \text{Holisticpower} + b_6 \text{Publicdummy} + b_7 \text{Remainingcontract} + b_8 \text{Ownerinvolve} + b_9 \text{Sizehotelrooms} + \epsilon
\]

where:

- \( Y \) = Propensity of hotel management to positively bias capital budgeting proposals
- \( \text{Mancontractdummy} \) = Management contract dummy variable (proposition 7a)
- \( \text{Franchisedummy} \) = Franchise dummy variable
- \( \text{Independentdummy} \) = Independent dummy variable
- \( \text{Holisticpower} \) = Holistic locus of power (proposition 7b)
- \( \text{Publicdummy} \) = Public dummy variable (proposition 7c)
- \( \text{Remainingcontract} \) = Remaining length of management contract (proposition 7d)
- \( \text{Ownerinvolve} \) = Owner involvement in the capital budgeting process (proposition 7e)
- \( \text{Sizehotelrooms} \) = Size of hotel property in terms of number of rooms (proposition 7f)
TABLE 14.15
Results of multiple regression analysis – Model 7
Dependent variable: Propensity of hotel management to positively bias capital budgeting proposals

The following variables are constants or have missing correlations: ‘Mancontractdummy’, ‘Franchisedummy’, and ‘Independentdummy’. They were deleted from the analysis.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>4.238</td>
<td>.676</td>
<td>6.274</td>
<td>.000</td>
</tr>
<tr>
<td>Holisticpower</td>
<td>-.129</td>
<td>.087</td>
<td>-1.141</td>
<td>.128†</td>
</tr>
<tr>
<td>Publicdummy</td>
<td>-.018</td>
<td>.290</td>
<td>-.158</td>
<td>.875‡</td>
</tr>
<tr>
<td>Remainingcontract</td>
<td>-.187</td>
<td>.023</td>
<td>-1.669</td>
<td>.049†*</td>
</tr>
<tr>
<td>Ownerinvolve</td>
<td>-.118</td>
<td>.119</td>
<td>-1.030</td>
<td>.153†</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>-.097</td>
<td>.001</td>
<td>-.827</td>
<td>.411‡</td>
</tr>
</tbody>
</table>

R = .309
R² = .095
Adjusted R² = .036
F Ratio = 1.602, p = .170‡

Notes:
† One-tailed test.
‡ Two-tailed test.
* Significant (p < .05) one-tailed.

The adjusted R² reveals that 3.6% of the variance of the dependent variable of propensity of hotel management to positively bias capital budgeting proposals is explained by the independent variables. The model is not statistically significant (F = 1.602, p = .170). The individual results of the regression analyses are presented below.

The regression model deleted the management contract dummy variable, franchise dummy variable and the independent dummy variable because they were constants or had missing correlations. The possibility of running a separate regression analysis using only the management contract dummy variable, franchise dummy variable and the independent owner-operator dummy variable as well as the hotel size control variable was explored. This model satisfied assessments for multicollinearity; multivariate outliers; and linearity and homoscedasticity. Table 14.16 presents the results of the multiple regression analysis, which is based on the following equation:

\[ Y = b_1 + b_2 \text{Mancontractdummy} + b_3 \text{Franchisedummy} + b_4 \text{Independentdummy} + b_5 \text{Sizehotelrooms} + e \]

where:

\[ Y = \text{Propensity of hotel management to positively bias capital budgeting proposals} \]
Mancontractdummy = Management contract dummy variable (proposition 7a)
Franchisedummy = Franchise dummy variable
Independentdummy = Independent dummy variable
Sizehotelrooms = Size of hotel property in terms of number of rooms (control variable)

### TABLE 14.16
Results of multiple regression analysis for proposition 7a
Dependent variable: Propensity of hotel management to positively bias capital budgeting proposals

<table>
<thead>
<tr>
<th>Variable</th>
<th>Co-efficient</th>
<th>Std. Error</th>
<th>t-value</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>3.239</td>
<td>.469</td>
<td>6.912</td>
<td>.000</td>
</tr>
<tr>
<td>Mancontractdummy</td>
<td>-.054</td>
<td>.460</td>
<td>-.277</td>
<td>.782‡</td>
</tr>
<tr>
<td>Franchisedummy</td>
<td>-.016</td>
<td>.525</td>
<td>-.125</td>
<td>.901</td>
</tr>
<tr>
<td>Independentdummy</td>
<td>-.103</td>
<td>.467</td>
<td>-.535</td>
<td>.593</td>
</tr>
<tr>
<td>Sizehotelrooms</td>
<td>-.190</td>
<td>.001</td>
<td>-2.606</td>
<td>.010‡</td>
</tr>
</tbody>
</table>

R = .189
R² = .036
Adjusted R² = .016
F Ratio = 1.772, p = .136‡

Notes:
† One-tailed test.
‡ Two-tailed test.
* Significant (p < .05) one-tailed.

The adjusted R² reveals that 1.6% of the variance of the dependent variable of propensity of hotel management to positively bias capital budgeting proposals is explained by the independent variables. The model is not statistically significant (F = 1.772, p = .136). The individual results of the regression analyses are presented below. The result of this separate regression analysis indicated that the direction of the relationship (i.e. negative) was not as expected and there was no statistically significant relationship found between the management contract dummy variable and the propensity of hotel management to positively bias capital budgeting proposals (p = .782; two-tailed test). This signifies that proposition 7a is not supported.

The direction of the relationship (i.e. negative) was as expected but no statistically significant relationship was found between holistic power and the propensity of hotel management to positively bias capital budgeting proposals (p = .128; one-tailed test). This signifies no support for proposition 7b (operator dominated management contract hotels have a heightened propensity to positively bias capital budgeting proposals).
The direction of the relationship (i.e. negative) was not as expected and no statistically significant relationship was found between public vs. private hotel ownership and the propensity of hotel management to positively bias capital budgeting proposals ($p = .875$; two-tailed test). This signifies no support for proposition 7c (hotel management contracted to public hotel owners have a relatively high propensity to positively bias capital budgeting proposals).

The direction of the relationship (i.e. negative) was as expected and a statistically significant relationship was found between the remaining length of hotel management contract and the propensity of hotel management to positively bias capital budgeting proposals ($p < .05$; one-tailed test). This signifies that proposition 7d (the shorter the time to expiry of a management contract, the greater the propensity of hotel management to positively bias capital budgeting proposals) is supported.

The direction of the relationship (i.e. negative) was as expected but no statistically significant relationship was found between hotel owner involvement in the capital budgeting process and the propensity of hotel management to positively bias capital budgeting proposals ($p = .153$; one-tailed test). This signifies that proposition 7e (high owner involvement in the capital budgeting process will lead to a low propensity for hotel management to positively bias capital budgeting proposals) is not supported.

The direction of the relationship (i.e. negative) was not as expected and no statistically significant relationship was found between size of hotel property and the propensity of hotel management to positively bias capital budgeting proposals ($p = .411$; two-tailed test). This signifies that proposition 7f (large hotels have a greater propensity to positively bias capital budgeting proposals) is not supported.

**14.10 Conclusion**

This chapter has described the statistical analysis of each of the twenty-three propositions developed in connection with the seven models described in Chapter 10. Testing has been pursued through application of multiple regression and logistic regression in the case of model 2. As hotel size is an important underlying factor affecting the nature of hotel
operations and management (Garcia-Falcon & Medina-Munoz, 1999; Vallen & Vallen, 2005), it was felt appropriate to include it as a control variable in the regression equations for models 1 through 4. In models 5 through 7, hotel size served as an independent variable.

Overall, statistically significant relationships have been identified for six of the seven dependent variables examined. In model 1 it was found that as hotel size (control variable) increases, management contracts are typically longer. In model 2, it was found that as hotel size (control variable) increases, there is a relative decrease in the use of the cash FF&E reserve accounting approach. In model 4 it was found that as hotel size (control variable) decreases, hotel owners have a greater propensity to release FF&E reserve funds. In model 5, where the single item index of sophisticated quantitative capital budgeting technique usage was used as the dependent variable, it was noted that greater hotel owner involvement in the capital budgeting process leads to reduced use of sophisticated quantitative capital budgeting techniques. Where the multiple item index of sophisticated quantitative capital budgeting technique usage was used as the dependent variable, it was found that hotels with management contracts make greater use of sophisticated quantitative capital budgeting techniques. In model 6, where the index of emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal was used, support was found for propositions 6e and 6f. This signifies that greater owner involvement in the capital budgeting process leads to greater use of qualitative capital investment appraisal techniques and large hotels make greater use of quantitative techniques in investment appraisal. Where the holistic emphasis attached to quantitative versus qualitative capital budgeting appraisal techniques in investment appraisal was used as the dependent variable, only proposition 6e was supported. With respect to model 7, support was provided for proposition 7d, signifying that the shorter the time to expiry of a management contract, the greater the propensity of hotel management to positively bias capital budgeting proposals. No statistically significant relationships were observed in connection with model 3. While some statistical associations have been noted, the bulk of the propositions were not supported. This may be due to the study’s limitations. In the next chapter, which concludes the study, a synthesis and discussion of the study’s main findings is presented together with an outline of the study’s limitations and potential avenues for further research.
CHAPTER 15
DISCUSSION AND CONCLUSIONS

15.1 Introduction

This chapter provides a synthesis and discussion of the study’s main findings. The study’s limitations and avenues for further research are also provided. The study’s broad objective was to further our understanding of factors relating to asset related expenditure management in Australian hotels. This is a topic that has drawn limited prior research attention. Theories and concepts informing the study were drawn from the literatures associated with agency theory and organisational power.

Two empirical phases have been undertaken: a qualitative phase that involved conducting interviews with twenty key stakeholders in the Australian hotel industry, and a quantitative phase comprising a questionnaire survey of General Managers (GMs) of Australian and New Zealand hotels with twenty or more rooms and a star-rating equal to or higher than three. These two research phases signify that a mixed methods research approach has been adopted. This approach is believed to have yielded relatively rich insights into hotel asset related expenditure practices. It should be borne in mind, however, that the unit of analysis was different between the interview phase (i.e. a variety of parties involved in hotel management) and the survey phase (i.e. GMs only) of the study. This factor may explain some of the differences noted using the two distinct research methods.

15.2 Synthesis and discussion of main findings

This section is structured according to the study’s eight main objectives, which were outlined in Chapter 1.

15.2.1 Objective 1: To investigate the locus of power between hotel owners and operators

The literature, which was mainly U.S. based, highlights that the locus of power in the negotiation of hotel management contracts in the early 1970s tended to favour operators as a result of their superior industry knowledge and experience (Armitstead, 2004; Beals &
Denton, 2005). By the 1990s, the hotel management contract had undergone major changes, and owners began to gain the upper hand in contract negotiations (Eyster, 1993; W. Hart & Connor, 1994). Nowadays, recently negotiated management contracts appear to represent a reasonable approximation of a balance in power between owners and operators (Beals & Denton, 2005). The most recently noted study conducted in Europe suggests, however, that the power balance is slightly favouring owners (Bader & Lababedi, 2007).

Findings from the interviews conducted in this study concurred in the most part with the literature. Prior to the 1990s, it appears that the locus of power in Australia was heavily in favour of operators. By the late 1990s and early 2000s, however, the power balance had swung much more heavily in favour of the owners. Nowadays, the locus of power between owners and operators appears to be continuing to shift back towards operators, but is currently slightly in favour of the owner. Figures given in the interviews suggest that in Australia the power balance is approximately 60% owner and 40% operator. When making this observation, however, it should be borne in mind that the interview sample is not sufficiently large to allow a confident generalisation to be made. Inconsistent with this tentative interview sample observation, results from the questionnaire survey indicate that operators hold approximately 60% of the power while owners hold 40%. On balance, it appears there is a relatively even balance of power between the two parties.

A further important dimension of the locus of power that was investigated concerns factors that affect it. The literature highlighted three factors affecting the locus of power between hotel owners and operators. These comprise: (1) the level of competition among operators, with more competition leading to lower operator power, and vice versa (Bader & Lababedi, 2007; Hanson, 2007); (2) the relative size of the hotel owner, with larger hotel owners holding more power, and vice versa (Bader & Lababedi, 2007; Beals & Denton, 2005; Haast, et al., 2006); and (3) the degree to which hotel owners are well informed of the agency challenges arising from the use of hotel management contracts, where being more informed leads to greater owner power (Armitstead, 2004; Beals & Denton, 2005).

Findings from the interviews conducted in this study added to this literature, as seven factors were found to affect the locus of power between hotel owners and operators. These comprise:

(1) hotel owner size, where larger owners can wield more power than smaller owners;
(2) hotel operator size, where larger operators typically wield more power than smaller hotel operators;
(3) the location of the hotel, where hotels located in CBD locations provide the owner with more power;
(4) strength of the operator’s brand, where a stronger brand gives the operator more power;
(5) composition of the operator’s management team, where more qualified and experienced GMs and financial controllers provide more power to the operator;
(6) the credibility and reputation of the owner or operator, where the better the reputation and track record of either party, the stronger that party’s power relative to the other party; and
(7) the size and condition of the hotel, where larger hotels in better condition provide owners with more power.

The literature has further highlighted that as hotel owners have gained more power in their relations with operators, they have become better positioned to negotiate shorter management contract periods (Barge & Jacobs, 2001; Eyster, 1997a; Haast, et al., 2005; Horwath & Horwath, 1988; Panvisavas & Taylor, 2006; Sangree & Hathaway, 1996). While the interview data represented support for this position, the survey findings failed to provide support for this view (see proposition 1) \( p = .184; \) one-tailed test). Where hotel size (control variable) increases, however, hotel management contracts were found to become longer \( p < .05; \) two-tailed test).

15.2.2 Objective 2: To investigate different approaches to FF&E reserve accounting in hotels

The literature highlights that the majority of hotels operating via management contracts adopt either a cash or notional (non-cash) FF&E reserve (Eyster, 1997b; Haast, et al., 2005). A small proportion of hotels operating with management contracts do not adopt any FF&E reserve, however (Barge & Jacobs, 2001; Haast, et al., 2005). While the literature fails to provide any information on the relative proportion of management contract hotels that use cash versus notional FF&E reserves, however, it does provide information regarding the proportion of management contract hotels that maintain an FF&E reserve. Within the Asia-Pacific region (Australia included), in 2001, 84% of management contract hotels had an
FF&E reserve (Barge & Jacobs, 2001). By 2005, within the same region, this had changed to 96% maintaining an FF&E reserve.

Findings made in the interview phase of this study extend the pre-existing literature by appraising the number of hotels adopting either cash, notional or no FF&E reserves. Interviewees indicated that in Australia around 50% of hotels run under a management contract maintain a cash FF&E reserve, around 45% have notional (i.e. non-cash) FF&E reserves and around 5% or less have no FF&E reserve. Descriptive information derived through the questionnaire survey largely support these observations. The survey data indicates that 51.5% of respondents adopt cash FF&E reserves, 35.4% have notional FF&E reserves and 13.1% have no FF&E reserve.

The literature highlights that operators typically prefer cash FF&E reserves so that they can gain access to cash as and when it is needed, while owners prefer notional (non-cash) FF&E reserves because they prefer control over their cash (Eyster, 1997b; Haast, et al., 2005). The interview findings highlight that the choice between the cash and notional FF&E reserve approaches is typically governed by the relative locus of power between owner and operator. Owners with strong power are likely to succeed in adopting notional or no reserves, whereas, owners with weak power are likely to adopt cash reserves. Survey results indicate that while the direction of the relationship was as expected, no statistically significant relationship \( p = .112 \) (one-tailed test) was found between holistic power and the application of cash FF&E reserve accounting. This signifies that the survey data failed to provide support for proposition 2 (owner dominated management contract hotels make low use of cash funded FF&E reserves). As hotel size increases, however, it was found that there is a decrease in the use of the cash FF&E reserve accounting approach \( p < .1 \) (two-tailed test).

15.2.3 Objective 3: To advance understanding with respect to the sufficiency of funds allocated to the FF&E reserve account

As outlined in the literature, gaining an accurate understanding of what constitutes a sufficient allocation to the FF&E reserve is one of the biggest challenges facing the hotel industry worldwide (Mellen, et al., 2000). Since the 1930s, the general rule of thumb has been to allocate three per cent of annual gross revenue to the FF&E (Brooke & Denton, 2007; Phillips, 2003; Ransley & Ingram, 2001). Interview findings suggested that the typical
allocation (after ramping up) to the FF&E reserve in Australia is around 3%. Descriptive information derived from the questionnaire survey indicates that for the entire sample, an average of 3.02% of gross revenue is allocated to the FF&E reserve annually.

It has also been noted in the literature that the majority of hotel owners and operators see a 3% allocation to the FF&E reserve as insufficient (see Ferguson & Selling, 1985; Ransley & Ingram, 2001; Reichardt & Lennhoff, 2003). To cover the true cost of FF&E expenditure, the correct figure is closer to 5% (Eyster, 1997b), greater than 5% (Haast, et al., 2005), or even 6% of annual gross revenue (Australia New Zealand & Pacific Hotel Investment Conference, 2006b).

The interview data collected in this study reveals that a more accurate allocation to cover all necessary FF&E expenditure after the first three to five years of a hotel’s operation is around 5% of gross revenue. Descriptive information derived from the survey supports this position, as it was found that for the sample, the true cost of FF&E expenditure is 5.07% of revenue. When considered in the context of the interview findings concerning current allocations made to FF&E reserves, this indicates that within Australia, FF&E reserves are currently underfunded by approximately 2% of revenue.

Despite the literature, interview and survey findings suggesting that current FF&E reserve allocations are insufficient, the literature indicates that some hotel owners persist in allocating only three per cent to the FF&E reserve because they see higher allocations and any associated larger accumulation of FF&E reserves as potentially undermining a rigorous appraisal of the need for FF&E expenditure (Higley, 2005c; Phillips, 2003). Maintaining FF&E reserve allocations at low levels therefore gives owners more control over how their FF&E allocations are spent (Beals & Denton, 2005; Haast, et al., 2005). Indeed, a culture appears to have developed whereby FF&E reserves are underfunded (Haast, et al., 2005). The findings from the interviews support this view that a major reason for FF&E reserve underfunding stems from owners wanting tight control over FF&E expenditure. Several other reasons for the continuing fixation with holding the FF&E reserve allocation at 3% of revenue were evident from the interview data collected. These are:

- The convention of basing the FF&E allocation on a percentage of gross revenue is flawed because it does not calibrate to country and regional variables. Holding all other things equal, two identical hotels that cost the same to maintain at a set standard
could be found in different parts of the world where there are dramatically different room rates charged. Assuming hotel one has a low room rate, it will have to allocate a higher percentage of it’s gross revenue to the FF&E reserve in order to accumulate the same dollar amount in the reserve as the second hotel that commands a higher room rate.

- Although international operating companies generally understand that FF&E reserve requirements are greater than three per cent of gross revenue in some parts of the world, it can nevertheless be beneficial for them to apply a universal approach, to avoid creating disillusionment or concern amongst owners. In London, for example, it can be possible to charge rates of up to $1,500 a night for a hotel room that would only sell for $250 in Australia. As a result, if owners discovered that the FF&E allocation in London were say one per cent but, for example, five per cent in Sydney, although the actual dollar amount allocated in the two hotels may be the same, intuitively the owner in Sydney may feel that the owner in London is getting a better deal.

- Although experienced owners understand that an allocation of three per cent of revenue to FF&Es reserve will represent an insufficient contribution towards FF&E expenditure, new buyers, particularly from overseas, can sometimes enter the hotel industry without an appreciation that more than three per cent is required.

- Although most hotel owners understand that three per cent is insufficient, they may persist with it, or attempt to reduce it as far as possible, due to their belief that it is saving them money. What these owners fail to realise, however, is that if FF&E spending is insufficient, despite short-term savings, it can adversely affect the long-term profitability of their hotel.

- The use of three per cent can assist hotel owners secure funding from banks. If a higher percentage of revenue were used, banks may be dissuaded from lending, as they typically use the three per cent figure in their calculations.

- It can be convenient for hotel owners to use the three percent of revenue figure in preparing for a sale. When hotels are to be sold, future FF&E requirements are typically incorporated into the valuation of the property at the rate at which FF&E reserve contributions are made. If this amount were raised, it could have a damaging effect on the appraised value of a hotel.
Setting the FF&E reserve at only three per cent is a useful bargaining tool for operators seeking to secure a management contract.

Most interviewees felt that, although grossly underfunded, there will be no major change in the universal rule of thumb of allocating three per cent of gross revenues to the FF&E reserve in the near future.

The literature also highlights that as hotel owners appear to have a preference for low FF&E reserve contributions, while operators prefer high FF&E reserve contributions, considerable tension can arise between owners and operators on this issue (Eyster, 1997a; H. M. Field, 1995; Guilding, 2003; Rushmore, 2001). The interview findings suggest that conditions favourable for owners succeeding in pursuing their preference for low FF&E reserve allocations arise where the owner is experienced and the operator has no capital invested in the hotel. It therefore appears reasonable to expect that the way these competing preferences play out is affected by the relative locus of power between the owner and operator. Owner dominated management contract hotels would therefore be expected to make lower allocations to FF&E reserve accounts (proposition 3a). The results of the statistical testing of the survey data, however, indicate that while the direction of the relationship was as expected (i.e. negative), no statistically significant relationship was found between holistic power and the adequacy of funds allocated to the FF&E reserve account ($p = .425$; one-tailed test).

**15.2.4 Objective 4: To advance understanding with respect to problems surrounding the release of funds from the FF&E reserve account**

The literature search revealed that the release of funds from the FF&E reserve is typically subject to owner approval (Aghion, et al., 1994; Eyster, 1997a; H. M. Field, 1995; Guilding, 2003; Horwath & Horwath, 1988; Rushmore, 2002). Some of the more recently negotiated management contracts, however, specify that owners are to provide sufficient FF&E funding to maintain the hotel at its ‘brand standard’ (Beals, 2004; Beals & Denton, 2005; Crandell, et al., 2004; Dickson, 2007; Dickson, et al., 2008; Haast, et al., 2005). The use of a brand standard clause means that if an owner refuses to release funds allocated to the FF&E reserve for budgeted FF&E projects, they may have their affiliation with the brand discontinued through termination of the management contract by the operator, should it be deemed that the
hotel is falling below the brand standard (Beals, 2004; Beals & Denton, 2005; Crandell, et al., 2004; Dickson, 2007; Dickson, et al., 2008; Haast, et al., 2005).

The interview data concurred with the literature that many management contracts feature a brand standard clause, which creates a legal obligation on the owner to release funds from the FF&E reserve to enable the operator to undertake budgeted FF&E projects. An important finding from the interviews was that even if a hotel fails to meet the brand standard, thereby giving the operator the right to terminate the contract, operators will seldom do this as it can lead to an overall loss of profitability to the operating company. An unwanted side-effect for hotel owners of the increased use of the brand standard clause has been that many hotel owners are now concentrating their FF&E reserve spending on projects that uphold the brand standard. The problem with this is that such spending may not necessarily represent an owner’s preferred spending approach. This goal conflict has resulted in some owners arranging FF&E spending so that the brand standard is only minimally maintained, which allows them to leverage as much as possible on the brand. The degree to which owners can do this, however, is limited by the fact that it is the operator that is charged with the preparation of the annual budget. A major driver of high priority projects in the FF&E component of the annual budget was found to be directed toward the meeting of brand standards.

A further important finding from the interviews was that the use of a brand standard clause does not necessarily mean that any more money is ‘allocated’ to the FF&E reserve, but it does mean that more than the typical annual three per cent of revenue allocation will need to be spent by the owner on FF&E. Where there are insufficient funds in the FF&E reserve to fund budgeted FF&E projects, although operators have a legal right to take the required funding directly out of the hotel’s cash flow, operators appear to refrain from such action in order to avoid creation of an adversarial relationship. Where there is an FF&E reserve shortfall for budgeted FF&E projects, the following agreements may be negotiated between the owner and operator:

- The owner agrees to fund the FF&E reserve shortfall, but the operator has to commit to rectifying the shortfall from the subsequent year’s FF&E reserve allocation.
The owner agrees to fund the FF&E reserve shortfall, but the operator might be asked to waive their management fees for a certain period of time. In this way the operator is effectively funding part of the expenditure.

The operator can be asked by the owner to expense the FF&E expenditure (i.e. as repair and maintenance expense), which will mean that the operator will suffer a reduction in their incentive management fee for the year, as these are typically tied to GOP.

The interview data also uncovered industry speculation that many owners like to see the systematic charging of CapEx projects (i.e. non-FF&E capital costs that should not be funded from the FF&E reserve) to the FF&E reserve so that the reserve becomes quickly exhausted. It was claimed that the adoption of such an approach is consistent with giving an owner greater control over how their money is spent during the year. The propensity for such owner behaviour is heightened where the owner is nearing the end of their investment time horizon (i.e. when they are about to sell). When owners take this approach, however, operators appear to counter it by using funding in the repairs and maintenance budget to fund FF&E projects. Another variation in budgetary behaviour occurs when an operator attempts to protect the FF&E reserve by getting the owner to fund projects that should be classified as FF&E, as an owner’s CapEx.

With regard to the findings of the questionnaire survey, although a strong rationale can be advanced concerning a lower propensity for the hotel owner to release FF&E reserve funds in owner dominated hotels (proposition 4a), no support was found for the existence of such a relationship (p = .241; one-tailed test). Also, the data failed to provide support for the view that ego-trip owners are more likely to make the release of FF&E reserve funds easy (proposition 4b). It was found, however, that as hotel size decreases, hotel owners have a greater propensity to release FF&E reserve funds. Not only does this make sense on the grounds that smaller hotels are likely to exert less power to limit FF&E reserve expenditure, but also the questionnaire survey indicated that for the entire sample, the true cost of FF&E is higher for small hotels (5.81%) than for medium (5.00%) and large hotels (4.83%).
15.2.5 Objective 5: To investigate the degree to which sophisticated capital budgeting techniques are applied in hotels

The wider literature highlights that in terms of capital budgeting techniques, payback and AARR are considered ‘simple’ while NPV and IRR are considered ‘sophisticated’ (Ballantine & Stray, 1999; Butler, et al., 1993; Haka, et al., 1985; Klammer, 1972; Pike, 1983). The hotel capital budgeting literature suggests that over a ten year period from 1990 to 1999, in U.S. hotels, there has been a general reduction in the use of sophisticated capital budgeting appraisal techniques (Damitio & Schmidgall, 2002). More recently, Guilding and Lamminmaki (2007) have provided evidence of limited hotel use of sophisticated capital budgeting appraisal techniques, with over half of the Australian hotels they surveyed exclusively using the payback method. Descriptive information derived from the questionnaire survey appears to support these findings. Using a seven-point Likert scale, with 1 representing ‘not at all’ and 7 representing ‘to a large extent’, it was found that the simple capital budgeting technique of payback was used the most (mean 5.52), followed by the sophisticated techniques of NPV (mean 4.47) and IRR (mean 4.36).

The literature highlights that five factors appear to have an effect on the usage of sophisticated capital budgeting techniques. These are: (1) whether the hotel operates with a management contract (Guilding, 2003); (2) the degree of hotel owner involvement in the capital budgeting process (Antle, et al., 1999; Collier & Gregory, 1995a; Gannon & Johnson, 1997); (3) the size of hotel owner (Guilding, 2003; Guilding & Lamminmaki, 2007); (4) whether the hotel owner is public or private (Farragher, 1986; Holmes & Nicholls, 1988; Kim & Farragher, 1981; McInish & Kudla, 1981; Pike, 1985); and (5) the size of the hotel property (Block, 1997; Danielson & Scott, 2006; Graham & Harvey, 2001; Guilding & Lamminmaki, 2007; Kocher, 2007; Lamminmaki, et al., 1996; Patterson, 1989; Pike, 1996; D. Smith & Wynne, 2006). These five factors acted as independent variables in model 5, where the dependent variable was sophisticated capital budgeting technique usage.

For the purposes of proposition testing, two separate regression models were formulated with two different measures of capital budgeting sophistication employed as dependent variables. When using the ‘single item’ index of sophistication, statistically significant support was found for the view that greater hotel owner involvement in the capital budgeting process leads to a reduced use of sophisticated quantitative capital budgeting techniques. When using
the ‘multiple item’ index of sophistication, it was found that hotels with management contracts use sophisticated quantitative capital budgeting techniques to a low degree.

15.2.6 Objective 6: To investigate the relative importance of quantitative investment appraisal techniques in hotels

The literature highlights that in the mid 1990s, members of the hotel industry, regardless of their size, placed considerable importance on the use of quantitative capital budgeting techniques (see DeFranco, 1997). Much of the reason for this was that they were viewed as being a powerful tool in the performance appraisal and control process (Brander-Brown, 1995; T. Jones, 1998). In a more recent study, however, Guilding (2006) found that hotels make higher use of qualitative capital budgeting appraisal techniques. In the survey phase of this study, respondents were asked to indicate whether they agree with the statement: “In my hotel, quantitative analysis is more important than qualitative analysis when appraising investment proposals” A seven point Likert scale was provided with 1 being “strongly disagree” and 7 being “strongly agree”. For the total sample, it was found that quantitative investment appraisal analysis was considered more important than qualitative analysis (mean 4.59).

Findings from the interviews provide additional insight into hotels’ relative use of quantitative and qualitative capital budgeting techniques. The mix of quantitative and qualitative investment appraisal techniques was found to be dependent on the size of a capital budgeting project. Capital budgeting projects under $10,000 can be characterised as ‘small’ and projects over $100,000 as ‘large’. Small projects appear to be mainly evaluated by qualitative capital budgeting appraisal techniques, but as the value of the investment increases, greater reliance is placed on the use of quantitative capital budgeting appraisal techniques. Regardless of the size of a capital budgeting project, however, it was found that there tends to be a mix of quantitative and qualitative investment appraisal techniques employed. It was also noted that hotel owners place a high emphasis on qualitative capital budgeting appraisal techniques, as they consider the inputs to the quantitative techniques too difficult to estimate correctly.

A further factor found to influence the extent of quantitative versus qualitative analysis of capital budgeting proposals is the type of hotel owner. Interviewees explained that hotel
owners can be classified as public (public companies) or private entities. Hotel owners that are public were found to make greater use of quantitative capital budgeting appraisal techniques than private hotel owners. The reason provided for this is that public hotel owners have a large number of shareholders, of which a high proportion are institutional. It was claimed that institutional shareholders prefer the justification of hotel capital expenditure on the grounds of quantitative appraisal as this is seen to be objectively based. Private hotel owners were also found to be more inclined to place importance on qualitative based appraisal, as many of their investment decisions are affected by ego issues as they impart their own judgements, views and tastes with respect to their hotel.

Based on the literature and interview findings, six propositions were developed concerning factors affecting the relative use of quantitative investment appraisal techniques. The factors were: (1) public vs. private hotel ownership; (2) hotel operating with a management contract; (3) size of the hotel owner; (4) locus of power between hotel owner and operator; (5) hotel owner involvement in the capital budgeting process; and (6) size of hotel property.

For the purposes of proposition testing, two separate regression models were formulated where an index and a holistic measure of the emphasis attached to quantitative versus qualitative investment appraisal factors served as dependent variables. When using the ‘index’ measure, support was found for the view that greater owner involvement in the capital budgeting process leads to greater use of qualitative capital investment appraisal techniques, and also the view that large hotels make greater use of quantitative techniques in investment appraisal. Support was also provided for the view that greater owner involvement in the capital budgeting process leads to greater use of qualitative capital investment appraisal techniques when the ‘holistic’ measure was used as the dependent variable.

15.2.7 Objective 7: To investigate the propensity of hotel management to positively bias capital budgeting proposals

The wider capital budgeting literature suggests that biasing of capital budgeting proposals has its foundations with asymmetric information, where the agency model is central (Bohlin, 1997). In a hotel capital budgeting context, it has been explained that where a hotel management contract is used, operators might try to inflate projected cash inflow estimates in an effort to persuade the owner to make an investment (Guilding, 2003). On the other hand,
negative cash flow data biasing may occur in instances where an owner attaches significant importance to metering outputs rather than monitoring behaviour (Guilding, 2003). Guilding’s (2003) empirical findings suggest the propensity to positively bias projected cash inflows is stronger than the propensity to negatively bias projected inflows.

Findings from the interviews highlighted that the potential biasing of capital budgeting proposals by operators is a source of varying concern among different hotel owners. Operators appear inclined to positively bias capital budgeting proposals towards projects that protect their brand, give their customers a consistent experience and raise their management fees. Owners, on the other hand, prefer the achievement of bottom-line profitability, which may be impeded by an operator’s attempts to positively bias capital budgeting proposals. The extent to which operators engage in the biasing of capital budgeting proposals appears to be dependent on the type of hotel owner and, more specifically, whether they are public or private. It appears that hotel management has a greater propensity to bias capital budgeting proposals when they are contracted to public hotel owners. Biasing of capital budgeting proposals also appears to become more difficult where a hotel owner becomes involved in the preparation of capital budgeting proposals, which can be the result of the owner having a higher locus of power relative to the operator.

Based on the literature and interview findings, six propositions concerning factors effecting the extent of hotel operator capital budgeting biasing were developed. These factors were: (1) whether a hotel operates with a management contract; (2) locus of power between hotel owner and operator; (3) public vs. private hotel owner; (4) remaining length of hotel management contract; (5) hotel owner involvement in the capital budgeting process; and (6) size of hotel property. Support was found for the proposition that the shorter the time to expiry of a management contract, the greater the propensity of hotel management to positively bias capital budgeting proposals.

15.2.8 Objective 8: To investigate whether hotel owner characteristics impact on the strategic focus and timing of capital spending

The literature highlights that the strategic focus of an owner is an important issue affecting their acceptance of a capital budget plan. Owners with short-term investment holding periods of five years or less can be characterised by a market timing strategy of ‘buy low and sell
high’ which may not be conducive to capital expenditure (Davis & DeRoos, 2004). Findings from the interview phase of the study confirmed that short-term oriented owners are likely to attach limited importance to maintaining the long-term integrity of a hotel. Longer-term oriented owners, however, are more likely to support more capital expenditure throughout their hotel ownership period. Despite the differing objectives of long-term and short-term focused hotel owners, however, the overriding factor determining the timing of capital expenditure appears to be the extent to which the market is rewarding an owner’s investment strategy. If the market is strong at the time of selling a property, purchasers are more likely to pay a premium for a hotel that is in particularly good condition (and vice versa). In addition, almost all hotel owners tend to limit capital spending late in their hotel ownership investment time horizon, because it can sometimes take two to three years for the expenditure to affect a hotel’s cash flow. A further reason for hotel owners limiting their capital spending towards the end of their investment time horizon stems from recognition that potential buyers may wish to convert their hotel to an alternative use. The merit of taking this approach can work against an incoming owner who might wish to continue the current hotel’s operations but would suffer a potential loss of marketplace credibility as a result of the hotel having become run-down. As a consequence, hotel owners need to carefully consider the capital spending trade off that arises towards the end of their investment period. They need to appraise the expected benefits secured from not spending relative to the impact that a deteriorating product might on the hotel’s value given anticipated market conditions at the time the hotel is to be sold.

15.3 Limitations of the study

While considerable effort has been made to address and minimise limitations in the course of conducting this research, as with any social science study, the study suffers from certain limitations. The main limitations concern the following:

1. **The questionnaire survey sample selection:** The population was all Australian and New Zealand hotels of 20 rooms or more and a star rating equal to or higher than 3. The study’s findings are therefore not generalisable to lower quality or smaller hotels. The results should also not be generalised to hotels outside of Australia and New Zealand.
2. **Subjectivity in responses:** While every care was taken to avoid the use of emotive terms, respondents may have suffered from social desirability bias when responding to opinion statements posed in the two phases of data collection.\(^1\) Data gathered in connection with the following topics may have caused a problem with social desirability bias due to their sensitive nature: (1) evaluation of the locus of power between hotel owners and operators; (2) the sufficiency of funds allocated to the FF&E reserve account; and (3) the propensity of hotel management to positively bias capital budgeting proposals.

3. **Small sample size:** The sample size for this study was up to 200 for questionnaire questions directed toward all respondents and up to 101 for those questions restricted to respondents operating under a management contract. Although this sample size is deemed adequate for the statistical tests carried out, such as multiple regression and factor analysis, Tabachnick and Fidell (2007) highlight that a larger sample size is highly desirable when carrying out such tests, as it provides a higher degree of confidence in the results obtained.

4. **Statistical tools used:** Multiple regression was the main statistical tool used, which assumes that data is continual. For most of the variables, however, a 7-point Likert scale was used for the data collection. Although this approach is consistent with that taken by many management accounting researchers (see Brownell, 1995), this matter should be noted as a potential limitation. Two respondents may have held identical views on a certain topic (e.g., locus of power between hotel owners and operators), yet may have recorded their responses using different points on the Likert scale.

5. **Limitations of the qualitative study:** Twenty interviews representing six different key hotel stakeholder groups were conducted. A richer study may have been achieved by also conducting an in-depth case study. Like all social scientific research, a balance had to be struck, however, between the depth and breadth of the study.

6. **Questionnaire measurement instruments:** While considerable care was taken in selecting measurement instruments that would yield valid and reliable data, it should be acknowledged that due to the novelty of many of the variables, in the majority of cases, pre-existing measures within the literature needed to be substantially modified for the

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\(^1\) Social desirability bias is a term that is used to describe the tendency of respondents to reply in a manner that will be viewed favourably by others (McBurney, 1994).
current study. Although there is no indication of any problems with regard to the validity or reliability of the measurement of any of the variables examined, interpretation of the findings relating to such variables should be undertaken with due regard to the novelty of the measures used.

7. **Unit of analysis of the questionnaire survey.** Interpretation of the results should be considered with regard to the unit of analysis of the questionnaire survey. The GM level was adopted as the unit of analysis as GMs were seen as holding the requisite knowledge required to complete the questionnaire and also comprised a large enough group to enable the collection of sufficient responses to enable a robust analysis. It must be noted, however, that for many of the variables under analysis, GMs were asked to comment about the standing of their hotel owner and also operator (e.g. in the locus of power measures). A more reliable study could have been achieved by also collecting survey data from owners and operators. Gaining access to, and obtaining a sufficiently high number of responses from owners and operators, however, would represent a highly difficult task. With the industry contracts gained throughout the course of this study, however, the researcher hopes to pursue this as an on-going research avenue.

Notwithstanding these potential limitations, due to a lack of prior academic research attention in the area, the study can be seen as constituting a significant step forward in the development of a better appreciation of issues arising in connection with asset related expenditure management in Australian hotels. The next section considers how the contribution of this study can be built upon in further research.

15.4 Implications of findings

The implications of the study’s findings in relation to theory development, practice, and future research will now be discussed.

15.4.1 Implications of findings to theory development

The use of agency theory and the related organizational power literature as a lens to investigate issues arising in connection with asset related expenditure, particularly with regard to management contract operated hotels, has extended Guilding’s (2003) study that
outlined capital budgeting issues arising in hotels mediated by a management contract. In this study, a somewhat perplexing issue has arisen, as in the quantitative analysis conducted, only eight of the many possible relationships examined have been found to be statistically significant, and one of these contradicts what one would have expected from agency theory. The findings of the interview phase, however, provided more support to the tenets of agency theory.

The inconsistency of the findings in the interview and survey phases suggest there are considerable challenges in conducting questionnaire based research concerning asset related expenditure practices. Such difficulties with questionnaire based research have been commented on by Collier and Gregory (1995a, p. 33): “questionnaire based research into the investment appraisal process may be giving misleading answers and clouding the resolution of the theory versus practice gap rather than assisting it.” Overall, perhaps the biggest implication that this study will carry for theory stems from its originality. As a research forerunner, it is to be expected that further related research will follow. By acting as a catalyst for more research into issues arising in hotels with regard to asset related expenditure, it is to be expected that this study will have a subtle long-term impact on theory. Consistent with this view, it is hoped that the study’s outputs represent a strong foundation for conducting further research in the area.

15.4.2 Implications of findings on practice

There are several ways in which this study has the potential to inform practitioner’s management of asset related expenditures. Firstly, practitioners interested in gaining an understanding of the main stakeholders involved in a management contract would benefit from reading the literature review presented as chapter 4. It is anticipated that prospective hotel owners would find the management contract stakeholder network particularly useful in securing an understanding of the main agency relationships arising in a hotel management contract. Such an understanding may break down any myths associated with management contracts, and better equip a prospective new hotel owner when engaging in management contract negotiations. Secondly, practitioners interested in understanding deficiencies in owner-operator capital expenditure goal congruency in those hotels operating with a management contract would benefit from reading the literature review and discussion presented in chapter 7. More specifically, should owners read chapter 7, they may be better
positioned to mitigate potential agency problems with prospective hotel operators by seeking
an operator remuneration structure linked to ROI or RI. Further, reading the literature review
provided in chapters 5 and 6 would also provide a synopsis of the differences between capital
budgeting in general and capital budgeting in hotels.

With regard to the findings of the study, practitioners would benefit greatly from reading the
descriptive questionnaire survey information presented in chapter 12 as they would be able to
benchmark their hotel to others in the industry. A heightened understanding of the use of
sophisticated and quantitative capital budgeting techniques may lead to better capital
budgeting decision-making, which carries considerable potential to increase the bottom-line
performance of a hotel. With regard to the sufficiency of funds allocated to the FF&E reserve
account, and what the true cost of FF&E is, practitioners would secure a greater appreciation
of the real cost of FF&E across the sector if they were to read the study’s interview and
survey findings. Mellen et al. (2000, pp. 2-3) note that with regard to understanding the right
amount to set aside, “The truth will set us free [because] the yields to be earned on this most
illiquid of investments [could] be predicted with greater accuracy which, in turn, [would]
theoretically attract more capital to our industry.” This study also provides considerable
insights into the importance of locus of control between owners and operators and the capital
budgeting issues arising from control imbalances.

15.4.3 Suggestions for further study

As many aspects of the study signify that it manifests significant forerunner qualities, it is to
be expected that researchers interested in hotel capital budgeting issues will find this thesis to
represent a valuable platform from which to build further research. It should be
acknowledged, however, that the results of the questionnaire survey provided some
disappointment as a number of apparently well rationalised propositions have not received
statistically significant support from the data collected. As noted above, it should be
remembered that due to the study’s novelty, many measures had to be adapted from the
literature. This signifies that they do not carry the benefit of a history of social scientific
examination. Although no plausible reason has been found to signify that the measures
developed failed to adequately measure the intended constructs, it is possible that this may
have occurred. In light of the nature of the findings, further research directed towards
replicating all or part of this study’s survey phase is to be encouraged. Such a step would also
provide an opportunity to conduct a time based comparison with the data collected in this study. Further research may benefit from an attempt to modify the measures of the constructs of interest in the study. A good example concerns the measures used to gauge the locus of power between hotel owners and operators. This measurement of power was crucial in this study as it was used in many of the multiple regression models. Further research could seek to administer the questionnaire to both owners and operators of hotels using the same five dimensions of power. Gaining access to a broad enough sample of owners and operators, however, could prove to be difficult.

Given the significance of the locus of power construct between hotel owners and operators, the implication of the construct could be considered in a range of hotel decision making arenas. As noted in this study, the locus of power between hotel owners and operators appears to be determined by a number of factors (i.e. strength of operator’s brand, condition of hotel etc.). Additional questionnaire based research could seek to determine the relative degree to which each of these factors affects the overall locus of power between hotel owners and operators. Another issue that could be explored in more detail is the issue of asymmetric information between the hotel owner and operator. Further, as noted in this study, it was postulated that the locus of power is essentially determined at the point at which the hotel management contract is negotiated. On this issue, further research designed to determine whether the locus of power between hotel owner and operator varies throughout the term of a management contract, appears to be warranted. A final area of further research connected with the locus of power between hotel owners and operators would be to seek to develop a register of common management contractual clauses, which could be assigned weights and related power indices so that the relative power balance could be determined in this manner. A caveat to this suggestion appears warranted, however, as Schlup (2004) notes that it is likely to be extremely difficult to weigh up the advantages and disadvantages of every clause in a hotel management contract.

A novel discussion concerning the management contract stakeholder network (see Chapter 4) was presented in this study. On this issue, only the main stakeholders involved were discussed. Further research could therefore be directed towards investigating the role of additional secondary stakeholders not already considered in this study. Where the hotel owner is publicly listed and/or the hotel operator is publicly listed, there may be the additional problem of separation of ownership and control in these companies (i.e. between
shareholders and the owner or operator). Further analysis of this issue would be welcome, as it may carry wider implications for agency theory. Also, in Chapter 9, the presentation of the interview findings revealed a number of interesting points about competitive dynamics. For example, the importance of hotel location on locus of power. Yet there seemed to be some evidence of institutionalised numbers (e.g. 3% FF&E reserve figure, which was noted to be a universal ‘rule of thumb’). Another example of an institutionalised influence was where institutional investors were said to require the application of quantitative investment appraisal techniques. There was also more evidence that biasing is more likely in contracts with publically-listed owners. Further research could therefore seek to provide an institutional theory informed analysis of hotel management contracting issues.

A further original examination regarding hotel management contracts and deficiencies in owner-operator capital expenditure goal congruency (see Chapter 7) was presented. Within this discussion, considerable emphasis was placed on the owner-operator relationship in the management contract and the implications of operator remuneration on capital budgeting goal congruency. A potential line of research enquiry extending the current study’s focus would be to examine the nature of a GM’s engagement in hotels operating with a management contract. Given the key role a GM plays in capital budget formulation (Rushmore, 2002), understanding the relative motivations of GMs and the way they manage tensions in interest between owners and operators would likely sharpen our appreciation of the dynamics at play in hotel capital budgeting. This could be achieved by investigating the remuneration of the GM.

Further research could also examine factors arising from the growing incidence of owner engagement of asset managers to monitor operators (Armitstead, 2004; Bader & Lababedi, 2007; Geller, 2002). This development can be seen to parallel growing owner realisation of inconsistencies between owner and operator interests (Feldman, 1995; Johnstone & Duni, 1995). Although asset manager engagement is designed to promote improved owner-operator interest alignment (Bader & Lababedi, 2007), it is notable that asset managers are traditionally recruited from the ranks of hotel management companies where they have been previously employed as GMs or Vice Presidents (Bridge & Haast, 2004). Asset managers’ attention, for example, is often “directed to short-term operational performance rather than long-term value enhancement”, which detracts from their potential to serve owners’ interests (Bridge & Haast, 2004, p. 252). Field study research into issues surrounding the degree to
which asset managers can promote owner-operator capital expenditure goal congruency is likely to be insightful and therefore welcomed. This could be achieved by investigating the incentives and remuneration basis of asset managers.

With regard to FF&E reserves, this study has illuminated the considerable difficulties experienced between hotel owners and operators concerning: (1) the sufficiency of funds allocated; (2) different approaches to FF&E reserve accounting; and (3) the release of funds from the FF&E reserve account. With regard to the sufficiency of funds allocated to the FF&E reserve account, further research appears warranted to extend the insights provided herein. Numerous reasons were revealed in the interviews regarding with respect to why FF&E reserves are continually under-funded (i.e. owner’s desire to control, to attract more financing from banks etc.). Further research could seek to determine the extent to which each of these motives impacts on the sufficiency of funds allocated to the FF&E reserve. Another potentially fruitful line of future research would be to determine the items that FF&E reserve monies are spent on and to compare these to other items of FF&E that are financed by the owner but not drawn from the FF&E reserve. Such research could determine if any systematic differences arise in the type of FF&E items paid for from the FF&E reserve as opposed to other FF&E items financed by the owner. In this way it might be possible to determine the extent to which operators expend FF&E reserve monies on items that are more aligned with short-termism and the enhancement of the operator’s brand value as opposed to the longer-term goals of the owner. Overall, given the significant difficulty experienced with regard to FF&E reserve accounting, an additional potential line of future research enquiry would appear warranted in connection with seeking to determine whether an alternative approach to funding FF&E expenditure can be found.

With regard to capital budgeting appraisal techniques deployed in hotels, the results of this study largely concur with previous studies (see e.g. Damitio & Schmidgall, 2002; Guilding & Lamminmaki, 2007), in that hotels appear to make relatively low use of sophisticated capital budgeting techniques. Further research could be directed towards determining why this is the case and whether the capital budgeting decision-making process is actually benefiting from such an approach. A further related finding of this study is that regardless of the size of

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2 Recall that approximately three per cent of annual gross revenue is allocated to the FF&E reserve but that this quickly becomes exhausted as the true cost of FF&E expenditure is slightly more than five per cent of gross revenue per annum.
capital investment, the qualitative portion of the investment appraisal is typically viewed as being an important facet of the analysis. While this study was able to shed some light on the reasons why this might be the case, further research could be directed towards determining whether the capital budgeting decision-making process is benefiting from such an approach.

In framing this study, agency theory and the related organisational power literatures have been drawn upon extensively. It is pertinent to note, however, that the personal traits of hotel managers will cause differences in the extent to which they engage in self-serving actions. As a result, it could be revealing to base a hotel asset related expenditure study on the decision psychology literature. This literature highlights the importance of individual character traits and how they have a bearing on the extent to which a responsible decision is made (Zsolnai, 2003). The extent to which the decision-maker is likely to make a responsible decision, however, draws upon the theory of ‘prospective moral responsibility’ first presented by Jonas (1979, 1984). As explained by Zsolnai (2003, p. 281), “the imperative of responsibility means caring for the beings involved in our actions”. In a corporate context, the most advanced model of moral responsibility is that presented by Goodpaster and Matthews (1982) and Goodpaster (1983). Following Frankera (1980), Goodpaster (1983) explains that moral responsibility is made up of two components, rationality and respect.

A good example of the way in which the theory of prospective moral responsibility leads to different decisions than those espoused under agency theory is available within the financial planning literature. Financial planners can be likened to hotel managers, acting as an agent and making proposals on how to invest their client’s money. In this setting, it has been found that the asset allocation decision is often affected by the presence of subjective judgment in the decision-making process as a result of a number of psychological factors such as expectations, traits, biases, different assumptions, perceptions, and interpretations based on the decision-makers own knowledge, experience, intuitions, and skill sets (Van de Venter & Michayluk, 2007). Further research could therefore investigate a number of the issues raised in this study by replacing the agency theory lens with a perspective informed by this alternative theory. It is also pertinent to note that the extent to which this alternative theory may hold true is further supported by the fact that as the workforce becomes younger and arguably more knowledgeable, such workers do not respect authority as much as the older generation (Nankervis, Compton, & Baird, 2005). The impact of this can be seen for
example, if one considers a young hotel owner who may have a high degree of power but elects not to exploit this factor in his dealings with an operator.

With respect to the manner in which the thesis has extensively drawn on the agency theory and organisational power literatures, it should be acknowledged that other theoretical frameworks could also provide useful perspectives. It could be argued that some of these alternative theoretical models would provide a more theoretically and ontologically commensurate structure. Transaction cost economics (TCE), for example, may be a productive way of studying issues concerned with hotel management contracting, as it considers: (1) search and information costs (i.e., costs incurred finding an owner or operator to contract with); (2) bargaining costs (i.e., costs incurred arriving at an acceptable contractual agreement); and (3) policing and enforcement costs (i.e., costs associated with ensuring that the other party adheres to the terms of the contract as well as the taking of any action should this not be the case) (Dahlman, 1979). In this way, TCE explicitly addresses contract vs. hierarchy issues and therefore represents a subtle approach to analysing a contracting context. In particular, TCE would appear to carry considerable potential to facilitate an analysis of issues relating to incomplete contracts and relational contracting.

A further benefit of using TCE may arise in connection with the Chapter 7 discussion of hotel management contracts and deficiencies in hotel owner-operator capital expenditure goal congruency. The problem concerning the management contract and capital expenditure goal incongruence appears to have some similarity to the basic control challenge confronted in the management of divisionalised corporations. Dickson, Williams, and Lee (2008) highlighted in Chapter 7 that in order to improve goal alignment between owner and operator, the hotel industry needs to develop an operator incentive mechanism that embraces operating performance throughout the course of the management contract and also recognises hotel resale value. Similarly, corporate management needs to develop appropriate incentives for managers in divisionalised companies that are divided into semi-autonomous investment centres. If this link can be made, then it may be possible to make comparisons with the corporate control literature. Once again, the TCE approach could be fruitful here in any discussion of incentives within the M-form (Williamson, 1985).
15.5 Conclusion

This chapter has provided an overview of the study’s main findings structured according to the eight research objectives outlined in the introductory chapter. This has highlighted the extent to which each research objective has been achieved via the two empirical research phases undertaken. In addition, a number of potential limitations of the research have been outlined. Finally, a number of potentially fruitful avenues for future research have been identified.

It is hoped that this study will seed motivation for further empirical work in the area of hotel capital expenditure management. Additional studies of hotel asset related expenditure can add to the diversity of management accounting research being conducted in a range of companies in a range of industries around the world. Such research has the potential to significantly add to our knowledge of such practices, thereby aiding management decision-making, planning and control.
A major study to further our understanding of asset related expenditure practices in the Australian hotel sector is underway. The project is being conducted by Professor Chris Guilding and Michael Turner of Griffith University and is being endorsed by Horwath Asia Pacific, Cushman & Wakefield Hospitality and Jones Lang LaSalle Hotels.

Some of the study’s objectives are:
1. To evaluate ways that power distribution between hotel owners and operators affects hotel capital budgeting practice.
2. To document different approaches to Furniture, Fittings and Equipment (FF&E) reserve accounting.
3. To investigate how hotel owner characteristics affect capital budgeting practices applied in hotels.
4. To explore whether hotels operating with a management contract employ distinct capital budgeting practices.

The study’s method
1. Following a literature search to identify key issues, twenty face-to-face in-depth interviews have been conducted with a cross sample of general managers, financial controllers, owners, operators, asset managers, lawyers and industry experts.
2. Following an analysis of the interview data, a mailed questionnaire survey directed to general managers in Australian hotels is now being undertaken. It is intended that this survey will be replicated every five years, to document capital budgeting trends.

The signatories below encourage your support and participation in this important study.

For further information, please contact one of our research team identified below:

Professor Chris Guilding  
Chief Investigator  
Department of Tourism, Leisure, Hotel and Sport Management  
Griffith University  
Tel: (07) 5552 8790  
Fax: (07) 5552 8507  
Email: c.guilding@griffith.edu.au

Michael Turner  
Doctoral Scholar  
Department of Tourism, Leisure, Hotel and Sport Management  
Griffith University  
Tel: (07) 5552 9231  
Mob: 0413 575 279  
Email: m.turner@griffith.edu.au
Dear (add name here),

I would be grateful if you would consider granting me an interview in connection with the Griffith University Study of Asset Related Expenditure in the Australian Hotel Industry. A flyer highlighting an endorsement of the study by several leading hotel management-consulting companies is enclosed.

Together with Professor Chris Guilding, I recently completed an initial round of interviews with six hotel industry experts in Sydney. The study has now progressed to the second stage of interviewing and we consider you to be a person that could provide valuable insights to the research project.

I am planning to carry out the interviews at some stage between the 2nd of April and the 27th of April. I appreciate that you are bound to have a busy work schedule but it would nevertheless be helpful if I could determine your availability for a meeting during the proposed dates on a day and time that suits. Should it be necessary, I may need to schedule further dates for the interview if you are unavailable. Experience suggests most interviews run for around one and a half hours. I will be providing all interviewees in this study with a copy of the executive summary of the study’s findings.

I will be calling you in the coming week regarding whether you would like to participate and if so, to organise a suitable time and date for the interview. I greatly appreciate your time and consideration. Should you have any queries please feel free to contact my supervisor or me using the details listed below.

Yours Sincerely,

----------------------------------------

Mr Michael Turner                  Professor Chris Guilding
PhD Student Researcher            Primary Supervisor and Chief Investigator
Department of Tourism, Leisure, Hotel Department of Tourism, Leisure, Hotel
and Sport Management              and Sport Management
Griffith Business School          Griffith Business School
Griffith University               Griffith University
Tel: (07) 5552 9231                Tel: (07) 5552 8790
Mob: 0413 575 279                 Fax: (07) 5552 8507
Email: m.turner@griffith.edu.au    Email: c.guilding@griffith.edu.au
Research objective 1: To investigate the locus of power between hotel owners and operators.

1.1) Where do you see the balance of power between hotel owners and operators today? How has this changed over the last 30 years?

1.2) What factors do you see affecting the locus of power between hotel owners and operators?

Research objective 2: To investigate the different approaches to FF&E reserve accounting in hotels.

2.1) What are the most common forms of accounting for the FF&E reserve in Australian hotel management contracts?
2.2) What do you see as determining a hotel’s FF&E reserve accounting approach?

2.3) How well do you think the FF&E reserve accounting approach works?

2.4) Where do you see the future of FF&E reserve accounting going?

Research objective 3: To advance understanding with respect to the sufficiency of funds allocated to the FF&E reserve account.

3.1) To what extent do you feel that FF&E reserve funding is sufficient?

3.2) To what extent do you see the allocation of FF&E reserve funds on a percentage of gross revenue appropriate?

Research objective 4: To advance understanding with respect to problems surrounding the release of funds from the FF&E reserve account.

4.1) To what extent do you feel there are ‘challenges’ in releasing funds from FF&E reserve?

4.2) How do different FF&E reserve approaches impact on the release of funds from the reserve?

4.3) Do management contracts create an obligation on the owner to release FF&E funds?
Research objective 6: To investigate the relative importance of quantitative investment appraisal techniques in hotels

6.1 To what extent is there a relative importance placed on quantitative investment appraisal in hotels?

Research objective 7: To investigate the propensity of hotel management to positively bias capital budgeting proposals.

7.1 To what extent do hotel management have a relative propensity to bias capital budgeting proposals?

Research objective 8: To investigate whether hotel owner characteristics impact on the strategic focus and timing of capital spending.

8.1) To what extent do you see different hotel owner characteristics impacting on the strategic focus and timing of their capital spending?

END OF INTERVIEW
APPENDIX D

Ethics approval for face-to-face interviews

Griffith University
Office for Research
Nathan campus, Griffith University
170 Kessels Road
Nathan, Queensland 4111
Australia
Telephone +61 (0)7 3735 5456
Facsimile +61 (0)7 3735 7994
www.griffith.edu.au

20 November 2008

TO WHOM IT MAY CONCERN

Griffith University Human Research Ethics Application – HSL/39/06/HREC

This is to confirm that Human Research Ethics Application HSL/39/06/HREC titled “An investigation into hotel capital budgeting decision-making” being conducted by Professor Christopher Guilding and Mr Michael Turner has been reviewed and approved by the Griffith University Human Research Ethics Committee (HREC). The authorisation for the commencement of this research has been issued from 12 February 2006 to 12 February 2009.

The HREC is constituted and operates in accordance with the National Statement on Ethical Conduct in Research Involving Humans

Please do not hesitate to contact me if you have any further queries about this matter.

Regards

Gary Allen
Manager, Research Ethics
Office for Research
APPENDIX E
Ethics approval for questionnaire survey

20 November 2008

TO WHOM IT MAY CONCERN

Griffith University Human Research Ethics Application – HSL/12/07/HREC

This is to confirm that Human Research Ethics Application HSL/12/07/HREC titled “An investigation of asset related expenditure management and accounting in the Australian hotel industry” being conducted by Professor Christopher Guilding and Mr Michael Turner has been reviewed and approved by the Griffith University Human Research Ethics Committee (HREC). The authorisation for the commencement of this research has been issued from 8 May 2007 to 13 February 2009.

The HREC is constituted and operates in accordance with the National Statement on Ethical Conduct in Research Involving Humans

Please do not hesitate to contact me if you have any further queries about this matter

Regards

Gary Allen
Manager, Research Ethics
Office for Research

Office for Research
Nathan campus, Griffith University
170 Kessels Road
Nathan, Queensland 4111
Australia

Telephone +61 (0)7 3735 5456
Facsimile +61 (0)7 3735 7994

www.griffith.edu.au

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Gold Coast Logan Mt Gravatt Nathan South Bank
Date
The General Manager
Address here

2007 SURVEY OF ASSET RELATED EXPENDITURE PRACTICES IN AUSTRALIAN AND NEW ZEALAND HOTELS

Dear Sir/Madam,

We are members of a Griffith University research team conducting a major study of asset related expenditure practices in the Australian and New Zealand hotel industry. This study forms part of a Doctor of Philosophy (PhD) academic program for the student researcher listed below. Our research team contact details are listed below:

Professor Chris Guilding
Primary Supervisor and Chief Investigator
Department of Tourism, Leisure, Hotel and Sport Management
Griffith University
Tel: (07) 5552 8790
Fax: (07) 5552 8507
Email: c.guilding@griffith.edu.au

Mr Michael Turner
PhD Student Researcher
Department of Tourism, Leisure, Hotel and Sport Management
Griffith University
Tel: (07) 5552 9231
Mob: 0413 575 279
Email: m.turner@griffith.edu.au

We would be most grateful if you could take about ten minutes to complete the enclosed questionnaire. You can be assured that your completed questionnaire will be viewed in the strictest of confidence. Should you choose to participate, you will receive an Executive Report that compares asset related expenditure practices across hotels, which will enable you to benchmark your hotel’s asset related expenditure practices to others in the industry. No individual hotels will be identified in the published research results, only aggregate data. The return of a completed, or part-completed, questionnaire can be accepted as an indication that you have consented to participation in the research.

We thank you in anticipation of your participation in the study. As you no doubt appreciate, each additional response strengthens the validity of the study’s findings. Should you have any questions please feel free to contact one of the researchers listed above.

Yours Sincerely,

Professor Chris Guilding
Mr Michael Turner

The conduct of this research involves the collection, access and / or use of your identified personal information. The information collected is confidential and will not be disclosed to third parties without your consent, except to meet government, legal or other regulatory authority requirements. A de-identified copy of this data may be used for other research purposes. However, your anonymity will at all times be safeguarded. For further information consult the University’s Privacy Plan at www.griffith.edu.au/ua/aa/vc/opp or telephone (07) 3735 5585. If you have a complaint in accordance with this request please forward these to the Manager of Research Ethics (Ph: (07) 3735 5585 or email: research-ethics@griffith.edu.au.
Section A: Hotel background information

1) What is the star-rating of your hotel? ______________________

2) Which of the following best describes your hotel’s ownership / management structure? Please tick.

- Management Contract
  (There is an agreement between a property owner and a hotel operating company. The hotel operating company takes on operational responsibilities. The owner owns the property and pays the hotel operating company a fee for managing the hotel).

- Franchise
  (For a fee, an independent hotel adopts the franchiser’s name and trademarks and receives services in return. Almost all the advantages of the chain are available for the franchisee: mass purchasing, management consultation, wide advertising, central reservations, and systems designs).

- Independently Owned and Operated
  (The entity operating the hotel is the same as the entity owning the hotel and no management contract or franchising arrangement has been entered into).

- Other (Please describe) ______________________________________

3) Which of the following best describes the owner of your hotel? Please tick.

- Specialist Hotel Management Company
  (This type of company specialises in managing hotels, e.g. Accor).

- Unlisted Property Trust
  (These are typically trusts that are not listed on the stock exchange, e.g. Colonial First State).

- Listed Property Trust
  (These types of owner typically invest in various classes of real estate, of which hotels are only one. A general property trust is listed on the stock exchange, e.g. Thakral, Mirvac).

- Specific Listed Property Trust
  (This type of trust invests solely in hotels and is listed on the stock exchange, e.g. Grand Hotel Group).

- Opportunity Fund
  (Opportunity funds are typically investment banks that hold hotels for only relatively short periods of time, e.g. Morgan Stanley).

- Developer
  (This type of owner has retained ownership of the hotel following management of its development, e.g. Sunland Group, Raptis Group, City Pacific Ltd.)

- Traditional Investment Institution
  (This type of owner is typically made up of large insurance companies and listed on the stock exchange, e.g. AMP, GIC)

- High Net Worth Private Investor
  (This type of owner can be an individual or a consortium of individuals holding the hotel as a privately funded asset, e.g. Mulpha).

- Strata Titled Ownership
  (Accommodation rooms are individually owned under separate property titles).

- Other (Please describe) ______________________________________

4) a) Approximately how many years old is your hotel? ______________________

   b) Approximately how many years have you been GM at this property? ______________________
5) Which of the following best describes the nature of your hotel owner’s entity? Please tick.

- Public
  (Shares traded on stock exchange)
- Private
  (No shares publicly traded)

6) What is the approximate size of your hotel?
   a) Number of rooms: ____________________________
   b) Annual sales turnover: AUD$__________________ million

7) What is your hotel owner’s approximate size? Please specify.
   a) Number of hotels owned (i.e. worldwide): ___________________ 
   b) Number of hotel rooms owned (i.e. worldwide): ____________________

---

**Section B: Factors affecting the preparation of hotel capital budgeting proposals.**

(Please circle appropriate number using the scale provided.)

8) In your hotel, to what extent do the following factors influence whether an investment proposal is given the go ahead?

<table>
<thead>
<tr>
<th>Factor</th>
<th>Not at all</th>
<th>To a large extent</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) The proposal is justifiable on financial grounds?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>b) The proposal can be justified on the basis of gaining marketplace competitive advantage?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>c) The proposal is justified by a thoroughly conducted strategic analysis (e.g. competitive positioning analysis, SWOT analysis)?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>d) The proposal appears justifiable on intuitive grounds?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>e) The proposal’s main sponsor (i.e. the manager most closely associated with the project’s initiation and development) has a strong company track record?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>f) Experience suggests that the project will be successful?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>g) The manager acting as the proposal’s sponsor is a shrewd negotiator?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>h) The manager acting as the proposal’s sponsor understands internal politics and uses this to advantage in seeking company approval?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>i) The project represents an opportunity to pre-empt the competition?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>j) Cash flow and profitability forecasts support the proposal’s viability?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>k) On the face of it, the proposal makes sound commercial sense?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
<tr>
<td>l) The project’s budget provides a good financial return?</td>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
</tbody>
</table>

9) In my hotel, quantitative analysis is more important than qualitative analysis when appraising investment proposals?

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
</tbody>
</table>

10) In my hotel, there is a tendency for investment project sponsors (i.e. the managers most closely associated with the project's initiation and development) to inflate projected cash inflow estimates in order to increase the likelihood of the project gaining the hotel owner's support?

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
</tbody>
</table>

11) In my hotel, revenue forecasts in capital budgeting proposals (not necessarily accepted projects) are typically overstated?

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Strongly agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 2 3 4 5 6 7</td>
<td></td>
</tr>
</tbody>
</table>
12) In my hotel, cost forecasts in capital budgeting proposals (not necessarily accepted projects) are typically understated?  
   Strongly disagree Strongly agree  
   1 2 3 4 5 6 7

13) The owner of my hotel derives considerable pride from the hotel's appearance?  
   Strongly disagree Strongly agree  
   1 2 3 4 5 6 7

14) Ownership of my hotel appears to provide an ego-trip for the owner?  
   Strongly disagree Strongly agree  
   1 2 3 4 5 6 7

15) To what extent was the owner's purchase of your hotel motivated by financial versus ostentatious considerations?  
   Mainly financial Mainly ostentatious  
   1 2 3 4 5 6 7

16) To what extent is your hotel owner involved in the hotel's capital budgeting process?  
   Not at all To a large extent  
   1 2 3 4 5 6 7

17) How often does your hotel owner initiate capital budgeting proposals without being asked?  
   Never Very often  
   1 2 3 4 5 6 7

18) How much influence do you feel your hotel owner has on the final approved capital budget in your hotel?  
   No influence A great deal of influence  
   1 2 3 4 5 6 7

19) How do you view the nature of your hotel owner's contribution to the capital budgeting process?  
   Not substantial Very substantial  
   1 2 3 4 5 6 7

20) To what extent are the following capital budgeting investment appraisal techniques used in your hotel?  
   Not at all To a large extent  
   a) Payback?  
      1 2 3 4 5 6 7  
   b) Net present value (NPV)?  
      1 2 3 4 5 6 7  
   c) Average accounting rate of return (AARR)?  
      1 2 3 4 5 6 7  
   d) Internal rate of return (IRR)?  
      1 2 3 4 5 6 7

Section C: Issues arising from the use of hotel management contracts  
(Please only complete this section if your hotel operates under a management contract, i.e. the hotel owner is not the hotel operator. If your hotel does not operate under a management contract, see instructions at end of questionnaire.)

21) What was the original length of your management contract? ________________ year(s)

22) Approximately how long is it until your management contract expires? ________________ year(s)

23) What type of Furniture, Fittings, and Equipment (FF&E) reserve accounting approach is used in your hotel? Please tick.

   □ Cash  □ Notional (non-cash)  □ No FF&E reserve  □ Other (Please describe below)  
   ____________________________________________________________

24) What percentage of gross revenue is allocated annually (after ramping up) to the FF&E reserve account in your hotel? ________________ %. If FF&E reserve allocation is based on a different approach, please describe: ____________________________________________________________
25) To what extent do you consider that the funds allocated to the FF&E reserve in your hotel are sufficient to fund FF&E expenditure?

<table>
<thead>
<tr>
<th>Not</th>
<th>Very</th>
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<tbody>
<tr>
<td>1</td>
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</table>

26) What percentage of gross revenue would be required to cover the true cost of reasonable annual FF&E expenditure in your hotel (after ramping up)? ________________%

27) In my hotel it can be hard to get the owner to release funds from the FF&E reserve?

<table>
<thead>
<tr>
<th>Strongly disagree</th>
<th>Strongly agree</th>
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<tbody>
<tr>
<td>1</td>
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<td>3</td>
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<td>5</td>
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</tbody>
</table>

28) How often does your hotel owner refuse to release funds from the FF&E reserve?

<table>
<thead>
<tr>
<th>Never</th>
<th>Frequently</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
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<tr>
<td>3</td>
<td>4</td>
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<td>5</td>
<td>6</td>
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<tr>
<td>7</td>
<td></td>
</tr>
</tbody>
</table>

29) How much do you have to pressurise your hotel owner in order to get funds released from the FF&E reserve?

<table>
<thead>
<tr>
<th>Not at all</th>
<th>Very much</th>
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<tbody>
<tr>
<td>1</td>
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<tr>
<td>3</td>
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</table>

30) In terms of your hotel owner and your hotel operating company, which entity is in a stronger position to:

<table>
<thead>
<tr>
<th>The operator</th>
<th>Equally</th>
<th>The owner</th>
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</table>

a) provide you with increased pay?

b) put pressure on you if they perceive you to not be supportive of their wishes?

c) require that their suggestions are carried out?

d) command your respect?

e) get you to act in order to win their respect and admiration?

f) influence your next promotion?

g) make things unpleasant for you at the hotel?

h) give you a sense of importance associated with fulfilling your responsibilities?

i) provide you with good technical suggestions?

j) make you feel valued?

k) give you special help and benefits in return for your co-operation?

l) make your work difficult?

m) make you want to achieve a high level of performance?

n) provide you with sound job-related advice?

o) provide you with a sense of being personally accepted?

31) In terms of influencing the hotel’s objectives/goals, which is more powerful?

<table>
<thead>
<tr>
<th>The operator</th>
<th>Equally</th>
<th>The owner</th>
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<tbody>
<tr>
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</table>

A degree of subjectivity can be called for in determining whether asset related expenditure is capitalised (i.e. placed on the balance sheet as an asset) or expensed (i.e. placed on the profit and loss statement as expense). Where this uncertainty arises:

32) To what extent does the owner of your hotel seek to capitalise the item?

<table>
<thead>
<tr>
<th>Not at all</th>
<th>To a large extent</th>
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<tbody>
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</table>

33) To what extent does your operating company seek to capitalise the item?

<table>
<thead>
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<th>Not at all</th>
<th>To a large extent</th>
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<tbody>
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<td>1</td>
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APPENDIX H
Flyer containing research team biographies

The Griffith University Hotel Capital Budgeting Research Team

Professor Chris Guilding - Chief Investigator

Professor Chris Guilding is a member of the Chartered Institute of Management Accountants. He has taught accounting and finance in universities in England, Canada, New Zealand and Australia. Chris is sole author of the Elsevier book Financial Management for Hospitality Decision Makers and lead co-author of the book The Key Elements of Introductory Accounting, published by John Wiley.

Chris has had a long-standing research interest in how management accounting systems may be tailored to meet the needs of marketing managers. He has conducted research concerned with valuing brands, accounting for competitors, trade credit management and customer accounting. He has more than 40 published research papers appearing in numerous top-ranking academic journals.

In recent years, Chris has been focusing his management accounting research on the hospitality and hotel industries. In 2005 and again in 2007, Chris chaired the Griffith hosted “Strata and Community title in Australia for the 21st Century” conference. He has secured several research grants for research into hotel capital budgeting systems and also agency issues arising in tourism-based condominiums. He has also secured several grants to support his research into strata title management issues.

Michael Turner – Doctoral Scholar

Michael Turner is a Doctoral Scholar at Griffith University. He began his PhD in 2006 after completing his Bachelor of Business degree in 2002 and then his Honours degree in 2005, both in accountancy. Following completion of these degrees, Michael was awarded the highly prestigious University Medal for outstanding academic achievement. This enabled Michael to obtain a fully funded three-year scholarship to undertake his PhD.

Michael teaches accounting courses at both the undergraduate and postgraduate levels. His current research focus concerns the capital budgeting practices of Australian and New Zealand hotels. This focus has been well received by the hotel sector due to the importance and challenges surrounding hotel capital budgeting, particularly in the presence of hotel management contracts. Michael’s thesis is entitled “An investigation of asset related expenditure management and accounting in the Australian sector”. His research is being endorsed and supported by Horwath Asia Pacific, Cushman & Wakefield Hospitality and Jones Lang LaSalle Hotels.
APPENDIX I
Questionnaire cover letter - second mailout

Date
The General Manager
Address here

2007 SURVEY OF ASSET RELATED EXPENDITURE PRACTICES IN AUSTRALIAN AND NEW ZEALAND HOTELS

Dear Sir/Madam,

Three weeks ago we sent you a questionnaire in connection with our research into Australian and New Zealand hotel asset related expenditure practices. This study has been endorsed and supported by Horwath Asia Pacific, Cushman & Wakefield Hospitality and Jones Lang LaSalle Hotels. This study forms part of a Doctor of Philosophy (PhD) academic program for the student researcher listed below. Our research team contact details are listed below:

Professor Chris Guilding  Mr Michael Turner
Primary Supervisor and Chief Investigator  PhD Student Researcher
Department of Tourism, Leisure, Hotel and  Department of Tourism, Leisure, Hotel and
Sport Management  Sport Management
Griffith University  Griffith University
Tel: (07) 5552 8790  Tel: (07) 5552 9231
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We would be most grateful if you could take about ten minutes to complete the enclosed questionnaire. You can be assured that your completed questionnaire will be viewed in the strictest of confidence. Should you choose to participate, you will receive an Executive Report that compares asset related expenditure practices across hotels, which will enable you to benchmark your hotel’s asset related expenditure practices to others in the industry. No individual hotels will be identified in the published research results, only aggregate data. The return of a completed, or part-completed, questionnaire can be accepted as an indication that you have consented to participation in the research.

We thank you in anticipation of your participation in the study. As you no doubt appreciate, each additional response strengthens the validity of the study’s findings. Should you have any questions please feel free to contact one of the researchers listed above.

Yours Sincerely,

Professor Chris Guilding  Mr Michael Turner

The conduct of this research involves the collection, access and / or use of your identified personal information. The information collected is confidential and will not be disclosed to third parties without your consent, except to meet government, legal or other regulatory authority requirements. A de-identified copy of this data may be used for other research purposes. However, your anonymity will at all times be safeguarded. For further information consult the University’s Privacy Plan at www.griffith.edu.au/ua/aa/vc/pp or telephone (07) 3735 5585. If you have a complaint in accordance with this request please forward these to the Manager of Research Ethics (Ph: (07) 3735 5585 or email: research-ethics@griffith.edu.au.

328
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