

# 1 THE ASSET LIGHT MODEL: A BLIND SPOT IN HOSPITALITY

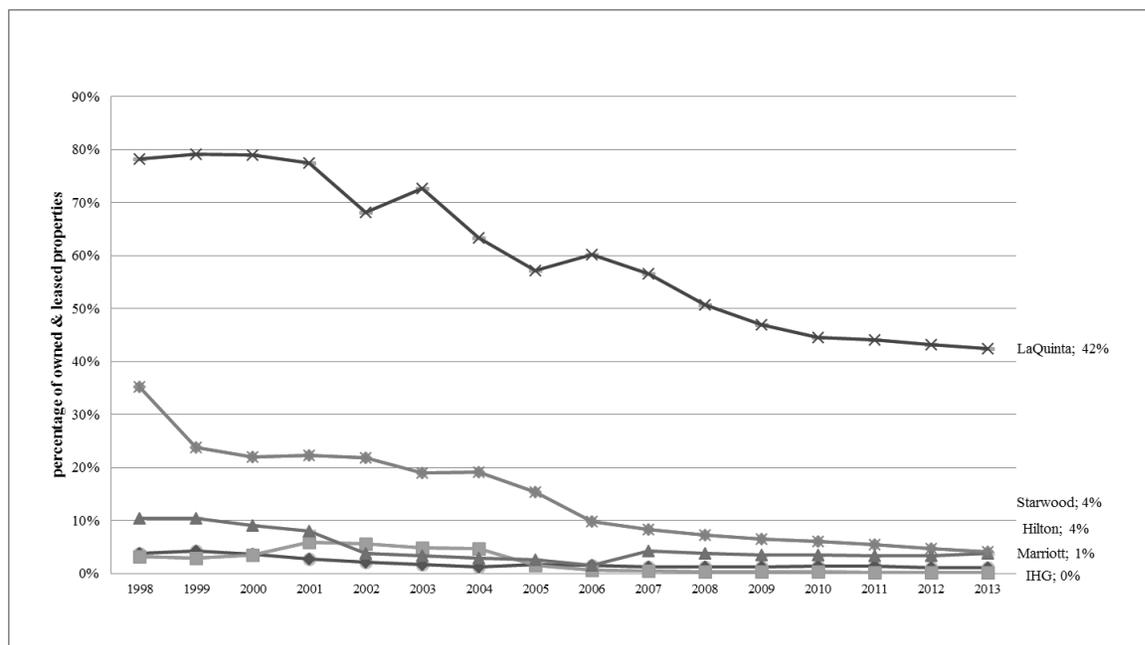
## 2 RESEARCH

### 3 INTRODUCTION

4 This research note raises the question of the lack of critical appraisal of the asset light model. Its  
5 purpose is to trigger an in-depth exploration of the determinants of performance of the  
6 implementation of such a model. The decision to divest properties and specialize in operations (i.e.  
7 the asset light model) has become a widespread practice amongst hotel corporations (Figure 1) and  
8 is often presented as the best fit for the organization (*The Economist*, 2013; Nair, 2014; Host and  
9 Marriott 1994 annual reports). This practice, whose advantages have been widely reported  
10 throughout academia, is becoming the new norm (Figure 1). The near universal acceptance of this  
11 model makes the dubious assumption that an asset-light strategy is the best fit, in terms of  
12 performance, for every organization in the hospitality industry.

13

14 Figure 1: The implementation of the asset light model



15

16 Source: Annual reports of respective companies.

17 This assumption contradicts the fundamental principles of strategy, whereby unique choices (of  
18 competencies and positioning) are what drives outperformance (Wernerfelt, 1984, Porter, 1979).  
19 Blindly accepting the asset light model as the best option for lodging corporations leads  
20 practitioners and academia to overlook strategy fundamentals and ignore the consequences of the  
21 model on long-term performance. This blind spot in our approach to the issue prevents us from  
22 addressing key questions such as, for instance, how to position the company vis-à-vis  
23 differentiation. Unfortunately, the lack of critical appraisal of the model is an obstacle to acquiring  
24 this knowledge.

25 Since it is accepted as the best choice for all companies, the asset light model and its effects on  
26 long-term performance is the subject of very few papers in tourism and hospitality research. These  
27 studies, with the exception of one (Low, Das, and Piffaretti, 2015), converge to confirm that the  
28 model is beneficial to corporate performance, which begs the question: How can just one  
29 divestment model be beneficial to the performance of all companies? Not to mention that  
30 companies implement it to different degrees, so what are the contingent variables which moderate  
31 the effects? Why are some companies more successful in generating superior performance than  
32 others after the implementation of the asset light choice? It appears that academia and executives  
33 are wearing blinders when it comes to this model. We hope that this research note will trigger more  
34 discussion for a more critical view of the asset light decision with a view to providing valuable  
35 insights for both academia and corporate practices.

## 36 EPISTEMOLOGICAL ISSUES

37 There are, however, practical aspects that explain the limited empirical research on the subject.  
38 The most important is the limited size of the population. The asset light model goes hand in hand  
39 with network size, which limits the number of hospitality corporations from which to collect data.  
40 The latest wave of mergers and acquisitions further exacerbates this limitation. Nevertheless, the  
41 blind spot that the asset light model represents is of an epistemological nature for three reasons.

42 First, the justification for the asset light model is, most often, based on ex-post interpretation and  
43 industry reports rather than scientific research. Articles argue that the model allows organizations

44 to adapt to macroeconomic changes such as modifications in debt market conditions and fiscal  
45 regulations on real-estate (Blal & Graf, 2013; Hudson, 2010). It also an attractive option to enter  
46 new markets (Brookes & Roper, 2012; Roper 2015), and a tool to mitigate risk (Sohn, Tang &  
47 Jang, 2013). Furthermore, practitioners and financial investors argue that it enables companies to  
48 diversify their risk profiles (Page, 2007). However, with the exception of three studies (Sohn et al.  
49 2013 and 2014; Low et al. 2015) on the impact of asset light on firm value, we have no scientific  
50 investigation of the performance benefits supposedly generated by the model.

51 Second, the few empirical studies that have evaluated the financial impacts of the model indicate  
52 that increasing the ratio of franchise and management fees to total sales and decreasing the  
53 proportion of fixed to total assets has a positive impact on firm value (Sohn, et al., 2013 and 2014).  
54 Nevertheless, using to the portion of revenues to operationalize the asset light model overlooks its  
55 effects on organizational design. Also, it does not factor in the impact of specialization. The study  
56 by Low et al. (2015) measures the role of hotel properties' asset class in mixed asset portfolios.  
57 The results reveal that lodging corporations that own their property assets outperformed  
58 organizations that had chosen an asset light model. These findings converge with articles in finance  
59 literature, which reveal that the asset light model has a negative scale effect (Yu and Liow, 2009)  
60 and a limited effect on performance.

61 Third, the asset light model entails a deliberate choice to specialize in one or more points along  
62 the value chain (Blal and Graf, 2013; Roper, 2015) and makes concurrent use of ownership  
63 transactions, leasing, franchising, and operating contracts. Therefore, its implementation requires  
64 the reliance on flexible organizational arrangements that make simultaneous use of transactions.  
65 Such lean and complex structures are very likely to increase coordination and operating costs, and  
66 thus, hinder the overall operational performance. Not to mention that not all companies in the  
67 industry have these skills. We propose that adopting the asset light model is a way of adaptation  
68 to a norm, but that its effects on performance are neither uniform across corporations nor  
69 immediate. Therefore, considering this model as a one-size-fits-all solution is a fundamental flaw  
70 that hinders the progression of research and contribution to management.

71 AN EXPLORATORY STUDY

72 The goal of our analysis is to examine whether the implementation of the asset light structure  
73 affects the financial performances in the lodging sector. The literature makes the link between  
74 financial markets and the asset light model. Therefore, we selected companies that are listed on  
75 the New York Stock Exchange and that pursued an asset-light strategy over of period of at least  
76 15 years. As the implementation of the asset light model started in the mid-1990s, we could observe  
77 the phenomenon over a 16-year period from 1998 to 2013. The mid 1990s marks the inception of  
78 the phenomenon.

79 The restructuring, mergers, and acquisitions that occurred in the industry limited the number of  
80 companies available for the longitudinal analysis. Six corporations constituted the available  
81 population for our research: Marriott, InterContinental, Starwood, Hilton, Choice, and LaQuinta.  
82 In addition, the panel data is imbalanced: out of these six corporations, we could collect the  
83 financial data of two (i.e. Choice and Starwood) for the whole period from 1998 to 2014.

84 To explore our argument, we examined the effects of the asset light model on three performance  
85 measures (i.e. the return on share price, Earnings before Interest, Debt, and Amortization-EBITDA,  
86 and Return-on-Equity-ROE) of six leading U.S. corporations over the 1998-2013 period. We used  
87 a longitudinal data design that combines both cross sections and time series. We did so to control  
88 for unobservable variables, such as corporate culture, that do not change from one year to another.

89 From CRSP/Compustat Merged Database we obtained financial data at a fiscal year frequency.  
90 We also used the data provided by Dr. French on his website to apply the Fama and French model  
91 to compute the stock returns. We manually retrieved the total number of hotels in the corporation's  
92 network and the number of managed and franchised hotels from the annual reports of the five  
93 leading lodging corporations. To address the limitations of past studies, we operationalized the  
94 construct of implementation of asset-light, by measuring the number of managed and franchised

95 properties over the total number of hotels in the corporation's network<sup>1</sup>. This variable, as opposed  
96 to the revenue proportion used in the literature, integrates organizational design aspects. We started  
97 collecting this information seven years ago, which allowed us to constitute a unique dataset on the  
98 asset light model.

99 To conduct our analysis, we use a longitudinal data design that combines both cross sections and  
100 time series to account for heterogeneity across panel units. The model controls for unobservable  
101 variables that do not change from one year to the next (e.g. business practices, or a firm's corporate  
102 culture, etc.). Based on the results of the Hausman test, we adopted the random effects model<sup>2</sup>. We  
103 also confirmed the robustness of our results using the fixed effects model. Finally, our model had  
104 the following specificities:

$$105 \quad \text{Performance} = \alpha + \beta_1 \text{light}_{t-\text{lag},i} + \beta_2 X_{i,t} + \varepsilon_{i,t}$$

106 We included a vector of measures to control for financial, economic, and operational  
107 characteristics (Table 1). Specifically, in the EBITDA model, we included four control variables.  
108 First, growth, that controls for the period-to-period difference of the log transformation of U.S.  
109 G.D.P. in nominal dollars. Data was retrieved from the Graduate Institute of International  
110 Development Studies (GIIDS). The variable accounts for the overall macroeconomic evolution  
111 and measures the change in performances due to a change in the business cycle. Second is the  
112 inflation level in the U.S. where data was obtained from GIIDS. Third is the total number of  
113 properties in the company's network. Finally, we introduced a year dummy for each year.

114 In the stock return model, we measured the percentage change in the stock price estimated with  
115 the Fama-French model. When we used the return on stock price as a measure of performance, we  
116 controlled for the liquidity (i.e. total cash available at the end of the fiscal year) and a measure of

---

<sup>1</sup> Formally, the explanatory variable of interest is defined as:  $\text{light} = \frac{(\# \text{Management properties} + \# \text{Franchise properties})}{\# \text{totals properties}}$

<sup>2</sup> In terms of significance the random effects model generates similar results compared with the fixed effects model.

117 leverage (i.e. total liabilities over total assets). When we used ROE to operationalize performance,  
 118 we controlled for the total number of properties, leverage, and market capitalization.

119

120 Table 1: Multivariate analysis of the short-term effects of asset light structures on financial  
 121 performance.

	<b>ln_ebitda</b>	<b>Return</b>	<b>ROE</b>
rf		0.00465 (0.05)	
mktrf		0.0144*** (5.14)	
smb		0.0141 (1.38)	
hml		0.00875 (1.15)	
leased	-1.538 (-0.08)	-9.702 (-1.17)	17.11 (0.53)
managed	-7.093 (-0.75)	-2.190 (-0.55)	11.62 (0.79)
franchised	-6.774 (-0.71)	-2.125 (-0.53)	8.060 (0.57)
owned	-6.208 (-0.72)	-2.417 (-0.67)	12.24 (0.91)
growth	-0.140 (-0.27)	-0.0406 (-0.27)	
inf	0.766 (0.36)	0.153 (0.24)	
total	-0.000400*** (-2.92)	-0.0000130 (-0.21)	0.000341 (1.45)
Cash		0.000211 (1.03)	
Leverage		0.129 (0.79)	0.187 (0.21)
market_cap			0.00000260 (0.03)
_cons	14.41 (1.56)	1.977 (0.51)	-8.643 (-0.61)
<i>N</i>	59	59	65

122 Estimates are reported. \*, \*\*, \*\*\* indicate significance at 10%, 5% and 1% levels respectively. The t-statistic are  
123 reported in parentheses.

124 The results are reported in Table 1. They show that the implementation of the asset light model  
125 has no impact on the long-term performance of these lodging corporations. The total number of  
126 properties in the network has a significant effect on performance, when measured with EBITDA.  
127 In addition, the return on market portfolio is the only variable with significant effect on stock  
128 return.

## 129 IMPLICATIONS

130 Our purpose with this research note is to cast doubt on a phenomenon that pressures companies  
131 towards imitation and norms. We argue that the asset light model presents contingencies and has  
132 limitations with regards to its effects on performance, which have been overlooked. We are hopeful  
133 that this note will trigger further debate within academia and practitioners to support the creation  
134 of new value-adding strategies for the hospitality industry.

135 Questioning this long-held assumption opens numerous avenues of investigation. First, the cost of  
136 specialization and its effects on performance have been understated so far when, instead, this issue  
137 could complement our strategy literature. Second, uncovering the contingencies of the asset light  
138 model could help further research explore the organizational characteristics in play in terms of  
139 boundary changes on performance. Having specialized hybrid structures reduces the risks  
140 associated with operating or owning the business. Nevertheless, research indicates that this link is  
141 contingent upon the nature of the activities, the complementarity of resources, and the access to  
142 existing resources (Barney, Wright & Ketchen, 2001; Mahoney, 2004). These factors can increase  
143 coordination and controlling costs, which can lead to a reduction in overall financial returns. Such  
144 investigation would contribute to both theory and practice as it would help organizations to decide  
145 between implementing the asset light model or another alternative. Finally, future studies could  
146 advance the field by examining the optimum mix of governance from a competencies standpoint  
147 to support a competitive advantage.

148 In conclusion, a critical stance on the implications of a model which is presented as the most fitted  
149 for an entire industry can provide valuable insights for management and academia. For starters,  
150 future research needs to empirically examine the long-term financial effects of the asset light  
151 model. Also, it would be valuable for both industry and academia to study the optimal asset light  
152 mix. Such research will enable companies to choose the type of contract, management contract,  
153 franchise setup, leases or other new form of contractual relationship that will maximize its  
154 performance. Also, in line with current advances in the strategic management literature, future  
155 investigation could include company-specific variables such as competencies and internal factors.  
156 However, this will only be possible if we dare to challenge the premise that just one model is the  
157 best route for companies in an industry.

158

159 REFERENCES

- 160 A short history of hotels: Be my guest. (2013, December 21). *The Economist*, Christmas special  
161 edition.
- 162 Barney, J., Wright, M., & Ketchen, D. J. (2001). The resource-based view of the firm: Ten years  
163 after 1991. *Journal of management*, 27(6), 625-641.
- 164 Blal, I., & Graf, N. S. (2013). The discount effect of non-normative physical characteristics on the  
165 price of lodging properties. *International Journal of Hospitality Management*, 34, 413-422.
- 166 Brookes, M., & Roper, A. (2012). Realising plural-form benefits in international hotel  
167 chains. *Tourism Management*, 33(3), 580-591.
- 168 Host Marriott. (1995). *1994 annual report*. Retrieved from  
169 <https://www.sec.gov/edgar/searchedgar/companysearch.html>
- 170 Hudson, K. 2010 Hotels posed to shed properties. The Wall Street Journal September, C11.
- 171 Low, W., Das, P., & Piffaretti, C. (2015). The role of hotels in mixed asset portfolios: revisiting  
172 the asset-heavy versus asset-light debate. *International Journal of the Built Environment and*  
173 *Asset Management*, 1(4), 273-292.
- 174 Mahoney, J. T. (2004). *Economic foundations of strategy*. Sage Publications.
- 175 Marriott International. (1995). *1994 annual report*. Retrieved from  
176 <https://www.sec.gov/edgar/searchedgar/companysearch.html>
- 177 Nair, S. (2014). Why InterContinental hotels' asset light strategy drives growth? Retrieved,  
178 March 26, 2015, from [http://finance.yahoo.com/news/why-intercontinental-hotels-asset-light-](http://finance.yahoo.com/news/why-intercontinental-hotels-asset-light-223805903.html)  
179 [223805903.html](http://finance.yahoo.com/news/why-intercontinental-hotels-asset-light-223805903.html)
- 180 Page, T. (2007). 'Asset-Light'—Managing or leasing? *Journal of Retail and Leisure*  
181 *Property*, 6(2), 97-99.
- 182 Porter, Michael E. "How competitive forces shape strategy." (1979): 21-38.
- 183 Roper, A. (2015). Vertical disintegration in the corporate hotel industry. *Current Issues in*  
184 *Tourism*, 1-6.
- 185 Sohn, J., Tang, C. H. H., & Jang, S. S. (2013). Does the asset-light and fee-oriented strategy create  
186 value? *International Journal of Hospitality Management*, 32, 270-277.

- 187 Sohn, J., Tang, C. H. H., & Jang, S. S. (2014). Asymmetric impacts of the asset-light and fee-  
188 oriented strategy: The business cycle matters! *International Journal of Hospitality*  
189 *Management*, 40, 100-108.
- 190 Wernerfelt, B. (1984). A resource-based view of the firm. *Strategic management journal*, 5(2),  
191 171-180.
- 192 Yu, S. M., & Liow, K. H. (2009). Do retail firms benefit from real estate ownership? *Journal of*  
193 *Property Research*, 26(1), 25-60.