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What is the value of loyalty?

Most franchisees are required to be a part of Marriott's rewards program; but do the benefits outweigh the costs? Are franchisees getting a fair deal? Will the merger of the SPG and Marriott rewards programs help or hurt franchisees? Has Marriott studied the value of the rewards program and changes in the program to its franchisees?

Since Marriott claims it does not have a fiduciary duty in its relationship with franchisees, franchisees need to safeguard their own best interests. In order to do that, franchisees need two things from Marriott: 1) a meaningful voice in the program's design; and 2) transparency about the program's economics. Those two things may help franchisees determine how loyal Marriott rewards members are, what exactly they are loyal to, and how much that loyalty translates to their hotels' bottom lines.

Overview

Prior to Marriott's acquisition of Starwood, the two companies operated distinct (but similar) rewards programs for hotel guests. Following the takeover, Marriott maintained both programs with the intent of ultimately merging them. As of August 18, 2018, that consolidation took place, giving birth to a new rewards program. The fundamental mechanics of the program remain the same, but the program's effectiveness in the post-merger environment should be explored.

The new program will continue to operate in a way that costs franchisees money on both ends: when guests earn points on hotel stays, franchisees pay Marriott. When guests redeem their points for free hotel stays at franchised hotels, Marriott gives franchisees limited reimbursements. Franchisees will know how limited those reimbursements are, but evidence suggests they have been less than the hotels' normal room rates.

But that cost is not without some potential benefit. If the program drives business to franchisees' hotels above and beyond the costs they incur from it, then it may be worthwhile in the long run. However, it may be difficult for anyone, including franchisees themselves, to make accurate assessments about how much this benefit is worth to any individual hotel.

Transparency

Marriott does not clearly state in its financial filings the cash flows, revenues or expenses of its rewards programs.[1] It claims not to be a fiduciary in its participation agreements, and so has been held by at least one administrative agency not to hold reward-program monies as a fiduciary.[2] The company claims its goal is to operate the program on a break-even basis,[3] but it does not provide enough evidence in public filings to determine whether or not this is happening.

This lack of information raises several questions, such as:

- How does any franchisee know whether the reimbursement they receive when guests use points to book hotel rooms is fair?
- How do competing Marriott-branded hotels know whether their reimbursement rates are similar?
- Do Marriott-operated hotels get reimbursements in the same manner as franchisees?

One piece of information Marriott did recently reveal may raise questions about who benefits from the program. Marriott's Form 10-K from 2017, filed with the Securities and Exchange Commission, states (emphasis added):

> "The recorded liability related to these [rewards] programs totaled $4,940 million at year-end 2017 compared to $4,541 million at year-end 2016 . We estimate the reasonableness and the value of the future redemption obligations using statistical formulas that project timing of future point redemptions based on historical levels, **including an estimate of the "breakage" for points that members will never redeem**, and an estimate of the points that members will eventually redeem. **A ten percent reduction in the estimate of "breakage" would have increased the estimated year-end 2017 liability by $269 million.**" – Marriott 2017 10-K, pg. 53.

If Marriott is charging franchisees every time customers earn points (and doing something similar with credit card partners), shouldn't that be the only factor that affects liability? In other words, if it can be assumed that some members will never use their points, shouldn't the dollar value associated with that "breakage" go back to the franchisees (through higher reimbursement rates or some other means)?

Impacts of the new rewards program

As the programs merge, several factors could impact the rewards program's value to franchisees:

1. Marriott's market concentration in many areas has increased. Customers may be more likely to choose Marriott-branded hotels by default. If true, that would reduce the differential benefit of the rewards programs.
2. The "loyalty" program extends to almost all Marriott brands. Can customers be loyal to 30 brands at the same time?
3. The new schedule of redemption costs for room-nights came out in early August; it resulted in a net decrease in points costs. In other words, the same amount of points could translate to more free room-nights that franchisees will need to grant.
4. A points pricing structure that incorporates "peak" and "off-peak" pricing for each hotel could result in customer confusion.

Loyalty wars or price wars?

Rewards programs are meant to attract customers for reasons other than price. Post-merger, there is an increased likelihood that for any franchisee in any area, there will be competing Marriott-flagged properties offering lower room rates. Customers could thus benefit from the rewards program and still stay at the lowest-priced option. The franchisees with the lowest room rates may wonder why they are paying Marriott for their guests to earn rewards points if the guests were likely to stay there anyway. Other franchisees may wonder why Marriott maintains so many competing brands.

The 30-brand problem … again

The concept of "loyalty" may also be stretched by Marriott's decision to have 30 brands. Franchisees may want to conduct a quick four-question self-test:

1. How many Marriott brands can you name off the top of your head without looking?
2. How many Marriott brands do you think the average consumer could name?
3. If the average consumer were asked to list Marriott's brands, would they remember yours?
4. If a consumer cannot name these brands, how exactly will the rewards program build brand loyalty?

How does your brand stack up? Here are the average points redemptions for a free room-night for each brand

Brand	Avg points required prior to 8/18/18	Avg points required as of 1/1/19	change
Protea	9268	8933	-335
TownePlace Suites	16369	16341	-27
Fairfield Inn	18068	16906	-1162
Four Points	17989	17236	-753
Courtyard	20561	19162	-1399
SpringHill Suites	21799	19646	-2152
Aloft	22313	19766	-2547
AC Hotels	22066	19809	-2257
Element	24512	20488	-4024
Residence Inn	23003	20631	-2371
Moxy	23485	22879	-606
Delta	25303	24545	-758
Sheraton	24391	24871	480
Renaissance	27143	27200	57
Marriott	27708	28292	584
Le Meridien	28266	29014	748
JW Marriott	30833	33095	2262
Westin	33270	33142	-128
Gaylord	33333	33333	0
Tribute Portfolio	32226	33548	1323
Autograph Collection	35183	36951	1768
Design Hotels	40612	40714	102
Marriott Vacation Club	38438	46250	7813
W Hotels	50167	47685	-2481
Vistana	41368	48947	7579
Luxury Collection	49816	49583	-232
Edition	50000	51500	1500
Ritz-Carlton	48511	51649	3138
St. Regis	61214	57619	-3595

Points will go further

In preparation for the merger of the SPG, Marriott and Ritz-Carlton rewards systems, Marriott recently completed a hotel-by-hotel re-evaluation of the cost for guests to pay for room-nights using rewards points. This re-evaluation actually resulted in a net decrease of 5,184,500 points for rooms across Marriott's portfolio for the base rate. This means that on average, customers will need to redeem 752 fewer points for a free stay at a hotel (a 3.1% decrease). Properties in the U.S. will be devalued more than the average: customers at U.S. hotels will be able to get free nights for 1,041 fewer points on average – a 5.1% decrease.

Will this matter to franchisees?

One way in which it might make a difference is that points will go further, allowing travelers to get more free nights. For those franchisees who receive less than 100% of ADR as reimbursement for these nights from Marriott, "points going further" could come at a cost.

Peak and off-peak

According to Marriott, "In early 2019 we will be introducing peak and off-peak pricing for reward stays."[4] The company's site currently does not indicate how the dates for peak and off-peak pricing will be set – whether there will be a single standard for all system hotels, whether it will be determined hotel-by-hotel, or somewhere in between. How much of a say will franchisees have? How will franchisees avoid price-fixing and anti-trust allegations? These questions lead to a fundamental dilemma.

On one hand, if Marriott controls the decisions over peak and off-peak dates, the company would be able to put franchisees at a competitive disadvantage relative to Marriott-operated properties.

On the other hand, if franchisees have full control over setting peak and off-peak pricing for their own properties, rewards members will have to figure out those schedules for each property they intend to stay at. This could make the process of comparing properties more confusing and difficult for consumers. If any of them misunderstand the system, they may end up redeeming more points than they thought, and feeling cheated by Marriott or by the hotel.

Furthermore, if each franchisee fully controls their peak and off-peak decisions, some franchisees could try to maximize the "peak" periods and minimize the "off-peak" periods to avoid points redemptions at their properties. If one hotel in a market does this, other hotels that do not follow suit may be at a competitive disadvantage.

There are other alternatives: Marriott could grant each franchisee a pre-defined number of peak and off-peak nights that franchisees could decide how to allocate on the calendar. To be fair, the number would need to be the same for all hotels, including those operated by Marriott. Although such a plan might appear more fair, it would not really solve the dilemma because it leads back down the road toward potential customer confusion.

No matter what happens, franchisees should keep track of how peak and non-peak nights for Marriott-operated hotels compare to those for franchised hotels; how the peak and off-peak nights compare across brands; how different geographical areas are treated; etc. Marriott claims no legal responsibility to treat franchisees fairly in this regard, and it has incentive not to.

Conclusion

The new, as-yet-unnamed rewards program leaves a number of questions unanswered. In order to understand the true costs and benefits of the program for all parties, franchisees need more information.

1. They may want to ask Marriott for an accounting of its rewards program revenues, expenses, cash flow, costs borne by each franchisee net of reimbursements, and any other information that could help them evaluate the program themselves.
2. Before finalizing a franchise agreement with Marriott, franchisees should make sure they fully understand the rewards program, and the rights and restrictions they have in implementing it.
3. Franchisees may want to study points redemption rates, and peak and off-peak allocations for their competitive set, especially for hotels Marriott operates.

Endnotes

1 Marriott SEC Form 10-K, pgs. 32, 49, 50, 53, 59, 60.
2 *In the Matter of the Petitions of Marriott International, Inc. et al., New York State Tax Appeals Tribunal, Decision DTA Nos. 821078, 821079, 821080, 821219, 821374, 821375, 821376, 821380, 821381, 821382, 821383, 821384, 821385 and 821753*, Findings of Fact, pgs. 3-4.
3 Marriott SEC Form 10-K for 2017, pg. 53
4 https://www.marriott.com/rewards/pointsGridPopUp.mi?awardType=Standard

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