



## HOSPITALITY LAW

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Week 3:

Hospitality Business Structures

# THE IMPORTANCE OF BUSINESS STRUCTURE

- ❖ One of the most appealing aspects of the hospitality industry is the opportunity for owning your own business. Whether they are interested in **owning restaurants or hotels, one establishment or a whole chain**, self - ownership is a strong factor in many people ' s excitement about the field of hospitality.

# Cont'

- ❖ Organizational structure refers to **the legal formation of the business entity.**
- ❖ This legal formation is important because the **courts and all levels of government** treat businesses and their owners differently, based on their organizational structure.

- ❖ Therefore, it is important to select an organizational structure that works to the advantage of both the business and its owner.
- ❖ Operating structure refers to **the relationship between a business 's owners and its management**

# COMMON HOSPITALITY ORGANIZATIONAL STRUCTURES

## 1. Sole Proprietorship

- A sole proprietorship is the simplest of all organizational structures.
- In this structure, **a single individual** owns all of the business and is responsible for all of its debts.

- Examples in the field of hospitality could include a **local hamburger stand, a doughnut shop, or perhaps a small bed and breakfast.**
- In a sole proprietorship, the personal assets of the owner can be used **to pay any losses, taxes, or damages** resulting from lawsuits against the business.

## 2. General Partnership

- A general partnership is similar to a sole proprietorship, **except that it consists of two or more owners** who agree to share the responsibility for the operations, financial performance, and liability of the business.

- Agreements will specify the contributions and responsibilities of each partner, including: **a)How much money each partner will contribute to the business, b)How much time each partner will contribute to the business, c)Who will make decisions on how the business is operated, d)How profits will be divided, How losses will be shared.**

### 3. Limited Partnership ( LP )

- While a sole proprietorship has only one owner, and a general partnership may consist of several owners, a limited partnership (LP) consists of **two** classes of owners: **the limited partner and the general or managing partner**

- The limited partner is simply someone who **invests money** in the partnership.
- The general partner may or may not be an investor but serves as the business 's **operating and financial manager**

## ANALYZE THE SITUATION 3.1

- NICHOLAS KOSTANTY formed a limited partnership with his father-in-law, Ray Sweeney, to open an upscale French restaurant in a Midwestern town. **Mr. Kostanty was the general partner and owned 75 percent of the business.**

- **Mr. Sweeney, with 25 percent ownership, was the limited partner and invested \$100,000.** After one year, difficulties in the restaurant's operation caused business to drop off, and Mr. Kostanty called Mr. Sweeney for advice.

- After hearing of the difficulties, and concerned with the security of his investment, Mr. Sweeney traveled from Arizona to Indiana to visit the operation. Upon observing the operation for two days, the two partners decided to launch **a large and expensive television ad** campaign to increase flagging sales.

- Mr. Sweeney designed the campaign with the help of Seelhoff Advertising and Video, a **local** advertising agency specializing in television commercials.

- Despite an immediate increase in sales, over time, **volume continued to decline, and finally, three months after the ad campaign was launched, the restaurant closed its doors.** Total debts at the time the restaurant closed equaled **\$400,000**, with assets of the partnership totaling only **\$200,000**. Included in the debt was **\$150,000** owed to the advertising agency. The agency sought payment directly from Mr. Sweeney.

- Mr. Sweeney, claiming that his liability was limited to the **\$100,000** he had previously invested in the business, refused to pay any additional money. The Seelhoff Advertising Agency sued the limited partnership, as well as Nicholas Kostanty and Ray Sweeney individually

# **Your comments:.....!**

1. By hiring the advertising agency, did Mr. Sweeney forfeit his limited partner status?
2. Is Mr. Sweeney liable for the outstanding debts of the limited partnership?

## 4. C Corporation

- A C corporation, often referred to simply as a **corporation**, is formed when groups of individuals elect to band together to achieve a common purpose
- When they do, the corporation has a **legal identity completely separate from that of its individual owners**

- Profits from a C corporation are taxed **twice**. The first tax is levied on the profits the corporation earns.
- Secondary, The individual owners are required to pay income taxes on their dividends.

## 5. S Corporation

- There is a type of corporation that avoids the double taxation inherent in a C corporation.
- This is known as an S corporation, and it also gets its name from the U.S. tax code. An S corporation is also known as a **subchapter S corporation**.

- An S corporation provides the same liability protection offered by a C corporation but must be established with the agreement of all shareholders.

## 6. Limited Liability Company ( LLC )

- **The limited liability company (LLC)** is a form of corporation created under state (rather than federal) law
- The limited liability company is a fairly new type of entity, created by some states to combine the best features of a corporation with the simplicity of a partnership.

- **Under** the typical **LLC statute**, the members (similar to shareholders in a corporation or partners in a partnership) are all protected from the company ' s debts

# COMMON HOSPITALITY OPERATING STRUCTURES



Jordan Hollander (2023), The Ultimate Guide to Hotel Operations ,  
[https://ucarecdn.com/2ef7a477-ddf4-45e3-84e4-  
be4a99791614/6aba166a51ec41aabaf46ec87747097d.png](https://ucarecdn.com/2ef7a477-ddf4-45e3-84e4-be4a99791614/6aba166a51ec41aabaf46ec87747097d.png)

- Now that you understand the manner in which **ownership of hospitality operations can be structured**, it is equally important to understand **the varied manner in which these businesses are managed and operated.**

# 1. Owner - operator

- A type of operating structure in which the owners of a business are directly responsible for its day-to-day operation. Also known, in some cases, as an **“independent.”**

## 2. Franchise

- A contract between a parent company (**franchisor**) and an operating company (**franchisee**) to allow the franchisee to run a business with **the brand name of the parent company**, as long as the terms of the contract concerning methods of operation are followed

- **Franchisee:** The person or business that has purchased and/or received a franchise.
- **Franchisor:** The person or business that has sold and/or granted a franchise

## ANALYZE THE SITUATION 3.2

- After five years of effort, you develop a unique style of roasting pork that is extremely popular in your hometown. You own and operate five units called Porkies that sell this product. Each unit costs \$175,000 to develop.

- Total sales of each unit average **\$600,000**, with a net profit margin of 10 percent per unit. A friend of yours discusses your success with you and suggests the possibility of opening five new stores in his or her hometown. Your friend wants to know what you would charge to sell **your recipe and your standard operating procedure (SOP) manual, as well as the use of the name Porkies.**

# **Your comments:.....!**

1. How would you determine a fair price for your experience?
2. If your friend is successful, causing the name of Porkies to be even better known, thus resulting in greater demand for franchises, should your friend share in future revenue from franchise sales?
3. What are the ethical issues at play here?

# Best Full Service Hotel Franchises



Hilton (2023), Hilton Galveston Island Resort,  
<https://www.hilton.com/im/en/GLSGIHF/3398941/tfo-0355-night-exterior.jpg?impolicy=crop&cw=6455&ch=2709&gravity=NorthWest&xposition=0&yposition=681&rw=1220&rh=512>

- Hilton is a very recognizable brand name in the hotel industry and **a leader in the hotel franchise industry.**
- They have offices, hotels, and resorts in **the North America, South America, Europe, Africa, the Middle East, and Asia Pacific.**

- This hospitality company has been **franchising since 1965**. Franchisees offer assistance with design and construction, management, and sales. The brand also has an extensive rewards program to bring in repeat customers.
- The franchise fee for this hotel franchise is \$75,000. And the total upfront investment ranges from \$29,162,700 to \$111,963,150.



Tunis (2022), Ouverture aujourd'hui du Tunis Marriott Hotel au Centre Urbain Nord,  
<https://tunisie.co/uploads/images/content/marriott-180422-1.jpg>

- Marriott International Inc. is a worldwide franchisor of hotels and lodging.
- It is also a premier name in the hotel business.
- There are more than 7,400 properties throughout 135 countries.

- The Marriott Group offers more than 30 hotel franchise models, from the Ritz-Carlton to Courtyard.
- The franchise fee for Marriott resorts is \$120,000. And the startup investment for new resorts range from \$74,129,490 to \$117,209,490



Ramsey Qubein (2023),The Guide to World of Hyatt Brands,  
[https://www.nerdwallet.com/assets/blog/wp-content/uploads/2020/08/Hyatt-Place-Los-Angeles\\_LAX\\_El-Segundo-PRINT-1440x864.jpg](https://www.nerdwallet.com/assets/blog/wp-content/uploads/2020/08/Hyatt-Place-Los-Angeles_LAX_El-Segundo-PRINT-1440x864.jpg)

- Hyatt specializes in fully personalized and collaborative relationships with franchisees.
- The company has been operating since 1957 and has about 700 hotel franchise locations across 56 countries.

- The brand has a team of development experts to work closely with each new franchise operator as they get new hotel locations up and running.
- The franchise fee for new hotels ranges from \$60,000 to \$100,000. And the initial investment ranges from \$13,645,000 to \$153,723,000.

# 3. Management Contracts

- **Management company:** An entity that, for a **fee**, assumes responsibility for the day-to-day operation of a business.
- **Management contract:** The legal agreement that defines the responsibilities of a business owner and the management company chosen to operate the owner's business.

## 4. REIT

- Some ownership and operating structures are quite unique.
- One of these is the **real estate investment trust (REIT)**.
- A REIT is form of business ownership that, in many cases, expressly forbids the owner of a business from operating it.

- Thus, for example, an individual REIT could own 300 hotels but not be allowed to serve a customer breakfast in any of them!
- As a REIT, a company can own hotel properties but in most cases must lease them to operating companies

# 5. Condo Hotels

- An increasingly popular hotel structure, and thus an increasingly common hotel organizational/operating structure, is the condominium or “condo” hotel (sometimes also referred to as a “mixed use” property).

## **Condominium:**

- A multiple unit complex (i.e., hotel, apartment house, office building), the units of which are individually owned with each owner receiving a recordable deed to the individual unit purchased, including the right to sell that unit and sharing in joint ownership of all common grounds, hallways, and on-site facilities.

## Fractional ownership:

- A purchase arrangement in which a condominium owner purchases the use of his or her unit for a portion (fraction) of a year. The fraction may be defined in terms of the number of days per year (i.e., 30, 60, etc.) or very specific days and/or months (i.e., January 1st. through March 31st. for example). Individual units purchased under such an arrangement are commonly known as “fractionals.”

# References

- [1] STEPHEN BARTH (2009), Hospitality Law: Managing Legal Issues in the Hospitality Industry , p 63-84 ,<https://www.pdfdrive.com/hospitalty-law-managing-legal-issues-in-the-hospitality-industry-e157128399.html>
- [2] Denney G. Rutherford, Ph.D (2007), HOTEL MANAGEMENT AND OPERATIONS, <https://www.pdfdrive.com/hotel-management-and-operations-free-mba-preparation-e173015.html>

Thank you!

Next lecture: Legally Managing Hospitality  
Property

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